103

# UNITED STATES-JAPAN FRAMEWORK TALKS ON TRADE

Y 4. G 74/7: J 27/3

United States-Japan Framework Talks...

## HEARINGS

BEFORE THE

COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE

OF THE

COMMITTEE ON GOVERNMENT OPERATIONS HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

FEBRUARY 24 AND MARCH 23, 1994

Printed for the use of the Committee on Government Operations

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# UNITED STATES-JAPAN FRAMEWORK TALKS ON TRADE

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## THURSDAY, FEBRUARY 24, 1994

HOUSE OF REPRESENTATIVES,
COMMERCE, CONSUMER, AND
MONETARY AFFAIRS SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
*Washington, DC.*

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2247, Rayburn House Office Building, Hon. John M. Spratt, Jr. (chairman of the subcommittee) presiding.

Present: Representatives John M. Spratt, Jr., Marjorie Margolies-Mezvinsky, Christopher Shays, and Stephen Horn.

Also present: Representative John Conyers, Jr.

Staff present: Theodore J. Jacobs, staff director; Thomas S. Kahn, chief counsel; Faye Ballard, clerk; and Marc M. Rose, minority professional staff, Committee on Government Operations.

## OPENING STATEMENT OF CHAIRMAN SPRATT

Mr. SPRATT. I will go ahead and call the meeting to order. We have a couple of members yet to arrive, and others with schedule conflicts will be arriving late. I think the chairman of the full committee is going to pay us a visit as well, but in the interest of time, we will get started.

Today, the Commerce, Consumer, and Monetary Affairs Subcommittee meets to discuss the present and future of United States-Japanese trade, with special emphasis on the framework talks. As everyone knows, these talks recently ended without an agreement. What we will examine today is: What should be America's next step? Should we impose sanctions on Japan? Do we, in Congress, move to reenact the Super 301 provisions of the trade act and allow the administration the broad authority to do whatever is necessary? Or should we wait, as some have urged, for currency fluctuations alone or a realignment of the dollar to cure the deficit?

Here is the background of the situation we find ourselves in. At the G–7 meeting in Tokyo in July 1993, President Clinton and then Prime Minister Miyazawa announced a new "framework" for addressing trade issues between our two countries. They agreed to measure progress in specific industrial sectors, using what the framework agreement described as "objective criteria, either qualitative or quantitative," to determine whether foreign companies had made strides in penetrating the Japanese market.

From the U.S. perspective, it was important that the framework process be different from previous negotiations, because most pre-

vious negotiations had been open ended and had produced little in the way of tangible, measurable results. The President called this the first "results-oriented" strategy ever accepted by Tokyo. The first four sectors to be addressed were automobiles and auto parts, telecommunications equipment, medical equipment, and insurance.

Negotiators have been meeting for months to figure out how to measure progress or the lack of progress in these areas. The President and now Prime Minister Hosokawa announced, however, on February 11 that the two countries were unable to reach any agreement, based upon numerical measurements, and we are now faced with the increasing possibility that the United States will impose some kind of sanctions on Japanese products coming into this country. While we insisted on some sort of measurable standard in cutting Japan's trade surplus, Japan says such benchmarks would amount to "managed trade."

This morning, we want to explore aspects of Japan-United States trade. We have had a trade imbalance with the Japanese, which does not need to be recited here. It has reached a record level of $60 billion a year. On the other hand, the Japanese are an important trading partner for us. They are our second largest trading partner. They buy more American products than any other foreign country, except for Canada.

Must we do something about the imbalance of trade between the two countries? If we do, what will be the impact on the average consumer if we impose sanctions, for example? What will be the impact if Japan responds in kind? What will be the impact on American workers whose jobs depend on sales to Japan? On the other hand, can we simply allow our trade deficit with Japan to drift, to depend upon the market for some kind of invisible hand or automatic adjustment?

These are the questions that we hope to answer with the testimony today, and we have a very distinguished panel of witnesses to address these questions for us. We start with a panel of experts who have had a great deal of experience in dealing with the Japanese.

Clyde Prestowitz is not here, but he will arrive shortly. He is a former senior Commerce Department trade official, who negotiated with the Japanese during his tenure in the Department. He is currently president of the Economic Strategy Institute.

Fred Bergsten is here this morning. He is a former Treasury Department official during the Carter administration. An expert on economic issues, he is currently director of the Institute for International Economics. Dr. Bergsten, we will begin with you. We have your testimony.

Before we begin, I would like to turn to Mr. Horn and ask him if he has any opening statement he would like to make.

Mr. HORN. Just a statement, Mr. Chairman. First, I commend you for holding these hearings. This is a crucial issue for the United States and for all citizens of both countries. There is no bilateral relationship which is more important than the United States-Japan relationship. In any mature relationship, we know that one experiences problems. The question is, how do we resolve them? However, I hope we can maintain in sight the common interest of both nations and their values during these present difficulties.

It is clear that the Japanese auto market is not as open as the American market. Everybody has their favorite reason: Restrictive dealer networks, cozy dealer-manufacturer relationships, the large expenses required for an initial investment in Japan, or the sloth of American industry in developing cars for use in the Japanese market. Each is at fault to some degree. In any case, we must realize that we trade because of the mutual gain that we derive from commerce.

Mr. Chairman, the ports of Los Angeles and Long Beach are in my district, and there are many exporters of manufacturing goods located in the 38th Congressional District. Many of the Japanese-owned plants here in the United States are an important part of America's manufacturing base, and a number of them also happen to be in my district. In fact, lean manufacturing techniques perfected in Japan have made an excellent contribution to the improvement of American industry. It is also obvious that the Japanese auto market must be further opened.

Mr. Chairman, you and the staff are to be commended for assembling an impressive collection of witnesses. I look forward to our witnesses' testimony on how best to achieve this goal, without endangering the important bilateral relationship we have with the Japanese.

Mr. SPRATT. Thank you, Mr. Horn. I would also like to offer for the record, if there is no objection, the testimony and opening statement of Representative Gene Green, who expected to be here but had to go to Texas this morning. If there is no objection, that will be made part of the record.

[The prepared statement of Mr. Green follows:]

Statement of Representative Gene Green
Government Operations Subcommittee on
Commerce, Consumer, and Monetary Affairs
February 24, 1994

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Thank you, Mr. Chairman, for calling this very important and timely meeting on the U.S.-Japan Framework talks.

The Japanese market is simply not as accessible to U.S. goods as the U.S. market is to Japanese goods. We have made several agreements over the past two decades that promised "fair" and "open" markets with "equal access", only to argue later about what those terms really meant.

The Framework Agreement was negotiated with an eye to remedy the problem in future negotiations by establishing "objective criteria" to measure the degree of openness of the Japanese market. Yet, we now seem to be arguing about what exactly "objective criteria" means. Some economists, members of the press, and, ironically, the Japanese are calling the U.S. position a precendent for "managed trade". I do not believe calling for "objective criteria" means quotas and guaranteed market shares. Because of the history of poor results in terms of increasing access to the Japanese market, I support the Administration's position of calling for a results-oriented agreement instead of settling for merely procedural changes on Japan's part.

I would like the panels to discuss today how the Framework Agreement will be different from past agreements; if there are any limits on the number or type of sectors that require using "objective criteria" to measure openness; how well do you think the Administration differentiated between "objective criteria" and "managed trade" in the press; how this present deadlock will affect consumers; and what further steps do they recommend for reducing the large trade imbalance in autos and auto parts.

Thank you, again, Mr. Chairman.

Mr. SPRATT. Dr. Bergsten, I was about to make your testimony, as filed, a part of the record, but I cannot find it. As I understand it, you are going to testify extemporaneously. You have testified on this subject many times. Let me simply say the floor is yours, and we look forward to your testimony.

## STATEMENT OF C. FRED BERGSTEN, DIRECTOR, INSTITUTE FOR INTERNATIONAL ECONOMICS

Mr. BERGSTEN. Thank you, Mr. Chairman. I apologize for not having a written statement, but I will try to be sufficiently lucid in my oral presentation to make up for it.

Let me start by stressing the fact, as you did implicitly in your opening remarks, that these framework talks with Japan have two separate though related components. One part deals with the overall trade imbalance that Japan is running, both with the world and with the United States. The other part deals with specific sectoral problems of the type that you listed.

They are related, but they are largely separate, and the remedies for them are largely separate, as recognized by the U.S. Government in the current negotiating effort. So I want to separate the two for purposes of presentation, go through each briefly; and then, of course, I will be happy to answer your questions.

The first issue, and the one that gets the most attention in the broad sense, is Japan's huge trade surplus, both its global surplus and its bilateral surplus with the United States.

Japan's global surplus, which I think should be the focus of this part of the talks, is now running at about $140 billion. Japan is the only G–7 country that is even running a trade surplus. It is the only country in the world running a large trade surplus. People sometimes confuse it with China, which has a big bilateral surplus with us, but China has a large global deficit in its trade and current account positions. Japan is literally the only large surplus country in the world.

What that means is that Japan is maintaining its production at home, and to some extent its jobs at home, by selling not to domestic markets but to foreign markets. That is another way to define a trade surplus. In a world where growth is relatively modest and unemployment is high, that essentially says that Japan is exporting unemployment to the rest of the world by running this large, and growing until recently, trade surplus with the world.

Of that $140 billion global surplus, a little less than one-half, about $60 billion, is with the United States. We naturally tend to focus on the bilateral imbalance, but I would suggest one important caveat to that thinking. The problem is that, given the geographical pattern of trade, we are never going to balance our bilateral position with Japan. The surplus should be much lower than it is—it should be about one-half what it is—but we are never going to balance it.

The reason is simple. I have analyzed this in two books. Even if the United States were running a zero balance in our global trade, and Japan were running a zero balance in its global trade, there would still be a bilateral surplus for Japan with us, simply because Japan has to import large amounts of primary products—oil, food, et cetera—from the Australias, Saudi Arabias, and Canadas of this

world. To balance that, it has to sell manufactured products to high-income markets—ourselves, Europe, and the like.

This triangular pattern of trade suggests that Japan will always run a bilateral surplus with us. We, therefore, should not aim at eliminating its bilateral surplus, although we should have it in mind as part of the global problem.

The administration, in my view, has quite rightly targeted the Japanese global surplus as an area to apply these quantitative indicators. It is suggested that Japan should essentially cut its global surplus by 50 percent or more. It should cut it to something like 1.5 to 2 percent of Japan's GDP, compared with the current 3 to 3.5. I proposed that in my latest book on the topic, released last summer just before the negotiations started. I think it is a very appropriate objective.

If that reduction were achieved in Japan's global surplus, it would bring its bilateral surplus with us down by, say, $20 billion to $30 billion. It would come close to cutting it in half as well. That would be a big payoff for American jobs.

Remember that every $1 billion change in the trade balance amounts to 20,000 U.S. jobs. So, if the Japanese bilateral surplus with us came down by, say, $20 billion—which I think is a quite feasible, very reasonable, and doable objective—that would increase U.S. net employment by something like 400,000 jobs. In other words, this is the side of the framework talks where the big money is.

I am not in any way denigrating or downplaying the sector-specific issues, and I will come to those in a minute, but the big money is in reducing Japan's global surplus and its aggregate surplus with us. We are talking on the order of potentially half a million additional American jobs in very high-wage industries, because that is where the exports come from. So that, I think, is not only a major objective in the effort, it should be the most important among our different goals.

The basic causes of this Japanese overall surplus lie in macroeconomic factors. The trade barriers are a part of it. In my book, I suggested that Japan's trade barriers were blocking out something like $10 billion to $20 billion per year of U.S. exports. So that is significant. It is one-sixth to one-third of our bilateral imbalance.

At best, however, it would take many years and many framework negotiations to get those numbers corrected. The current four sectors that are being discussed would be only a very small proportion of that total. It is important, but it is not the big story. The big story is macroeconomic, and it is really two factors.

Japan is now in its third year of domestic recession—essentially zero growth of domestic demand. When your domestic economy is not growing, your demand for imports is not growing. In addition, since your companies cannot sell to growing domestic markets, they increase their export efforts. The two sides of that lead to the big increase in Japan's trade surplus. So its domestic recession is a big factor.

The second factor is the exchange rate of the yen. You may remember that the yen doubled in value against the dollar back in the middle 1980's. The result was just as a textbook would predict: Their surplus and our deficit came way down. People sometimes

forget this in saying that past efforts with Japan did not work, to the contrary.

In 1986, Japan was running a global current account surplus equal to 4.3 percent of its GDP. In 1990, it was down to 1.1 percent, a mere $35 billion in absolute terms. Now it is $140 billion, more than $100 billion more. Likewise, the U.S. current account deficit came down from 3.7 percent of our GDP in 1987 to less than 1 percent in 1991. The correction of the exchange rates and the pickup in domestic growth in Japan had worked.

What has happened subsequently, though, is that Japan went into domestic recession with the effects I mentioned, and the yen was permitted to weaken again very sharply, 20 to 25 percent in 1989 and 1990, again improving Japan's price competitiveness by an enormous amount. The two things combined to produce this enormous ballooning of its surplus.

The remedies are fairly straightforward to this part of the problem. Again, it is twofold. One, lean very hard on Japan to stimulate its domestic economy rather than relying on foreign markets and a trade surplus. The Japanese, for reasons that are really inexplicable and inexcusable, have failed to take domestic stimulus measures. They are running a structural budget surplus. They do not have a problem like we do, with an inability to use fiscal policy. They have a consolidated budget surplus.

Despite all the announcements of fiscal stimulus programs, the budget has stayed in surplus since 1987, and the budget surplus has grown in many periods during those years. In other words, despite the talk, there has been no fiscal stimulus. There has been no domestic expansion program. Inexplicably, Japan has not yet done it.

On this one, the United States is on the side of the angels. Every poll in Japan shows that the populace in Japan wants an expansionary domestic program, that it wants tax cuts to stimulate the economy. To put it bluntly, it is the bureaucrats in the Ministry of Finance and a few other obstructionists who are blocking what is obviously needed, both for Japan's internal purposes and to bring their trade surplus down as we want.

So we should keep hammering on that part of the issue, essentially allying with Prime Minister Hosokawa, the Japanese business community, and the Japanese public, all of whom want expansionary domestic measures. On that one, we have the high ground, no doubt about it. We should continue to push.

The second thing on the macro side is the exchange rate, and here there is good news. The yen has risen very substantially in the exchange markets over the last year to 18 months. It has gone up about 20 to 25 percent. If it can be held in that stronger range, say between 100 yen to the dollar or 110 yen to the dollar, then I think, combined with the domestic stimulus, there is a very good chance that our goal of getting Japan's global current account surplus cut in half over the next couple of years will in fact occur.

On the exchange rate, I think the U.S. Treasury Department has been a little slipshod on a couple of occasions. Last summer, they intervened to keep the yen from strengthening further, when it threatened to go beyond 100:1. I think that was all right, but they should obtain a clear quid pro quo from the Japanese that they

would cooperate to keep the yen from weakening again, say beyond 110.

The yen did, about 1 month ago, weaken back to 112 to 113, beginning to give back the adjustment gains that had been achieved by the earlier rise. Subsequently, when the Hosokawa/Clinton talks broke down 2 weeks ago, the yen shot up in the exchange markets in reaction. It is now back to about 105 to the dollar, which I would say is a good comfortable rate to achieve the kind of competitive gain for the United States that I talked about.

There are also press stories in Japan that when Secretary Bentsen was in Tokyo 3 weeks ago, he conveyed to the Japanese the strong message that the United States did not want to see the yen weaken below 110. I hope that is correct. That would be good news. That would essentially set us in a target zone of 100 to 110. Combined with Japanese stimulus, it would, I think, bring their surplus down.

I would add one caveat to that, however. If the Japanese continue to fail to stimulate their domestic economy, then the exchange rate of the yen would have to get even stronger to bring their trade surplus down to the requisite level. It might have to go to something like 90 to 95 to the dollar, rather than stabilizing between 100 and 110.

That is the macroeconomic side. I think the news there is partially good, with the exchange rate correction. That needs to be locked in. We need to keep pressing on domestic stimulus. Those two things together would give us a big payoff, including in terms of good U.S. jobs, as I mentioned.

The second part of the talks is the sector specific, item-by-item issues. There is less money in that, in terms of the aggregates, but it is still considerable and worth pursuing. The fact that Japan continues to have these pervasive barriers to market access there is a totally separate issue that we ought to go after, even if Japan were to have a trade deficit.

These are not level playing fields. The Japanese are blocking out foreigners. I would go after those sectors in any event. I certainly would not, Mr. Chairman, per a question you raised in your introductory statement, wait for the macroeconomic efforts to pay off or in any way be deterred in going after the sector-specific barriers. I think that is very important.

As I mentioned, my book of last summer suggested that the total effect on United States exports of Japan's trade barriers was something like $10 billion to $20 billion. The four sectors being considered now, as I said, are only a small part of that, but we are still talking about significant money, and these sectors ought to be pursued.

It is also worth noting, and this is contrary to some of the conventional wisdom, that some of the past negotiations with Japan have in fact worked. I mentioned the yen exchange rate corrections, but some of the sector-specific talks have worked as well. Japan's liberalization for cigarettes, for beef, for citrus, and the semiconductor deal—all those things have worked. So it is a fallacy to say that past efforts to liberalize have failed.

In fact, in many cases, including some of those I mentioned, the contemporary forecast of how much our exports to Japan would ex-

pand if it liberalized turned out to be gross underestimates by factors of 5 or 10, indicating that when the Japanese do open their markets their consumers respond like other consumers to lower prices, better quality, and the like. Negotiations can, in fact, work.

In addition, we should not be totally negative or pessimistic about the outlook. Japan has done a fair amount of trade liberalization of late. In the final Uruguay Round negotiations in Geneva that culminated just 2 months ago, the Japanese liberalized the famous rice market, which has been probably their most politically difficult one.

They agreed on the zero-for-zero tariff approach eliminating their tariffs on a number of sectors that give us good export opportunities. Bilaterally, they agreed to liberalize their construction market under the threat of U.S. retaliation just a month ago. So it is not as if Japan never liberalizes. It does in fact happen, and in fact the results from past liberalizations have been good.

The question is what to do now with the framework? In the book that I did on this and published last summer, we looked very carefully at 12 specific sectors, running across the Japanese economy: Agriculture, high tech, medium tech manufacturing, such as autos, financial services, and other services. What we found was a pervasive pattern of Japanese corporate exclusionary practices, reinforced by government interventions that do in fact make it very difficult, if not impossible, for outsiders to get into the market.

Incidentally, sometimes it is hard for outsider Japanese to penetrate the market, but it is certainly hard for foreigners. That, in a sense, is the crux of the problem. It is a pervasive pattern. It does link corporate practices and government intervention. That makes it more difficult to penetrate than the usual trade barriers that you find in other countries, where you can identify a quota or a high tariff.

It has been likened to an onion in the case of Japan: If you peel off one protective measure, you find two or three others. You may have thought you liberalized and opened the market, but in fact, there was much more to it, and you did not get to the heart of it.

That is why the United States, to answer one of the questions you raised in your letter of introduction, has gone to this so-called, results oriented approach. Instead of the usual approach of identifying a barrier and trying to eliminate it, the United States has said, "It is too complicated. We simply want to go to the bottom line and get an increase in imports."

That was done in the semiconductor deal. I think it has basically worked, and that notion could work in other sectors as well. I supported that in my book. I said that in certain sectors it certainly is worth trying and may be the best way to proceed.

Tactically, one has to back it up with threats of retaliation. That has been the history of this business. In fact, there is a sad but true element in all of our past negotiations with Japan. I go back to when I was doing this in the government in previous stints for over 20 years. The Japanese, unfortunately, have seemed to need outside pressure to get them to make the changes they ought to make for purely internal reasons. This is the famous gaiatsu, the foreign pressure which Japanese political leaders have often said

publicly they needed in order to reduce their barriers and overcome entrenched domestic opposition to the forces of protection.

So the current procedure of the administration, of threatening retaliation in the Motorola case and more broadly in the framework talks, is an unfortunate but necessary element in the whole picture.

I think the administration has somewhat painted itself into a corner by getting itself labeled as a proponent of "managed trade." That is ridiculous on the face of it. What the administration is trying to do is to open markets in Japan that are closed. In other words, it is trying to unmanage trade rather than manage it. But the administration has done a terrible job in terms of its public relations. It has let Japan, through diplomatic offensives and PR efforts, capture the high ground, paint Japan as the free trader and America as the interventionist. That is a bizarre outcome. Nevertheless, that is in the public mind around the world.

It is very important for two reasons. It is very important for the domestic debate in Japan, where the United States can and should have a lot of allies. In past trade negotiations, such as the structural impediments initiative in the late 1980's, the United States mobilized strong domestic support in Japan for its initiatives, and that is one reason it succeeded. At the present, however, the United States has let itself be painted as the bad guy.

In addition, it is critical with other countries. Other countries, again taking a bizarre view, are tending to support Japan, whereas they would gain enormously from United States efforts to open the Japanese market. The United States was very clear in the framework agreement that its efforts to open Japan's markets were not just for United States products but would open them for imports from everywhere. The most favored nation term is used explicitly in the framework agreement, correctly in my view.

That means the Europeans, the Koreans, the Thais, and everybody else ought to be cheering the United States on and supporting it to open the market, but those other countries have been put off by U.S. tactics: The fear of so-called aggressive unilateralism, the fear of retaliation, the Super 301's, and all that.

You asked about Super 301. I do not think Super 301 is so super. I do not think it adds much to our trade arsenal. We can do everything under regular 301 that we can do under Super 301. What Super 301 clearly does is scare the hell out of the Koreans and the Chinese and other people around the world who are, therefore, further deterred from supporting us vis-a-vis Japan, because they are afraid that if we use those tools, they will be sideswiped, and they will be next. That is something to keep very much in mind when deciding how the Congress should get into this act.

I think the administration has to sell its approach much more effectively. If it does, it ought to be able to prevail. It ought to stick to its guns for the reasons I indicate. The markets do need to be opened, and the United States should continue to pursue them.

My final point is that the United States, I think, does need to broaden the arsenal of tools it is using. Instead of simply saying "quantitative or qualitative indicators" on every sector and looking to the Japanese to come up with numbers, there are a few additional things we could do.

One is to launch antitrust suits against collusive practice by Japanese corporations. This seems to be a natural, and I think we should be pursuing it. Much of the problem identified in my book and identified by the administration in the talks really is rooted not so much in government intervention in Japan but, rather, in preferential buying practices by companies and horizontal market sharing among companies. Those are things that antitrust policy can and should attack.

In addition, a great advantage of antitrust efforts is that with them, we avoid shooting ourselves in the foot. You mentioned, Mr. Chairman, and Mr. Horn mentioned too, that when we retaliate against Japan in the traditional trade sense, we are cutting our consumers off from products. We are cutting our firms off from high-quality inputs and that may hurt their competitiveness. We are certainly hurting our exporters in selling to Japan because of the risk of counter retaliation and all that. By contrast, the antitrust approach does not have any downside for us. It reclaims the moral high ground, and I think it could be very effective in some sectoral cases.

Another possibility is antidumping cases, if Japanese export prices do not reflect the rise in value of the exchange rate of the yen. I stressed earlier that the higher yen is really the most potent tool we have to bring down the Japanese surplus.

Incidentally, it is also the most potent tool for dealing with the auto problem, which is over one-half of our bilateral deficit with Japan. There is a chart in my book that shows a perfect correlation between the yen/dollar exchange rate and the relative shares in the U.S. auto market of American and Japanese companies.

If you ask the auto companies, as you have, they will tell you that the most important thing U.S. policy can do for them is maintain a strong exchange rate for the yen. The CEO of General Motors, in giving his yearend review of GM's improvement a month or so ago, put at the top of his list, in terms of trade, the strong exchange rate for the yen. It has a huge payoff in terms of the auto trade, because autos are a very price-sensitive product, as are auto parts. So we get a lot for the exchange rate in that context, and again, we do not shoot ourselves in the foot.

Back to the basic point: Antidumping duties would help reinforce the exchange rate effect. One of the objectives of a stronger yen from our standpoint is to raise the price of Japanese products and make them less competitive with us here, in Japan, and in third markets. If the Japanese exporters do not pass on that higher price to the American market, then we do not get that benefit. So our antidumping laws should be attuned to the need for higher exchange rates to be reflected in higher product prices. Again, we would be fully within our rights to do that.

Another option is to take Japan to the GATT in a few cases. We have done it in the past with some agricultural cases in the late 1980's. It works. There were 10 sectors in which we won GATT cases against Japan in agriculture in the late 1980's. The Japanese complied with the liberalization requirement in every one of those cases. Those efforts did pay off. Whenever we can find GATT cases—relating to government procurement or relating to standards, which are some of the issues that cause difficulties in some

of the sectors now being discussed—we should take them to the GATT.

Again, it gives us the moral high ground, but it also leads to a likely high success rate, at least given past performance, and particularly with the improved dispute settlement process in the GATT that has come about as a result of the Uruguay Round.

Many things are a part of this problem. I have suggested a half dozen or so specific initiatives the United States ought to continue taking. I think the basic thrust of the framework agreement has been correct. Some of these mid-course corrections now, I think, can push it through to a very positive outcome.

Mr. SPRATT. Thank you very much, Dr. Bergsten.

Let me acknowledge the arrival of Chris Shays and Ms. Margolies-Mezvinsky. I am glad to have both of you.

Has Mr. Prestowitz arrived yet? We will proceed with the questions.

Let me start the questions by asking you if you agree with the proposition that having some kind of yardstick to measure whether or not we are making progress with the Japanese is a desirable goal? You have several different indicators here. One is a global surplus. The other is our bilateral surplus. The bilateral surplus clearly matters most to us in terms of our prosperity, wealth, and employment here. We do not want the Japanese to build up so many claims against the U.S. economy that they can buy any American company at will. We want some kind of fairness in the trade relationship.

Lester Thurow developed the proposition that it was better to have targets like this and to say to the Japanese, "We want you to adjust your trade, looking toward these objectives," than to tell the Japanese specifically what they should do internally. It was better, less intrusive to the Japanese, and less insulting to them to simply say, "We want you to adjust downward on this platform by this series of adjustments," as opposed to saying, "Change your distribution network. Change your government procurement policy. Change your economic stimulus policy."

Instead of dictating policies to them, you simply dictate results and let them decide what the means need to be. What is wrong with that?

Mr. BERGSTEN. The first problem with it is that it is clear the Japanese do not agree with Professor Thurow that it is less intrusive to tell them what their results should be than what their approaches should be. There is some logic on their side.

Mr. SPRATT. Do you not think it is less intrusive to say to a country, which understands better than any other country in the world the meaning of trade and the need to have a trade surplus, "This country, the United States, has the same policy objectives as your country has pursued since the Second World War, having a trade surplus, and we have to rectify the trade balance. The old classical economic theory is not working."?

Mr. BERGSTEN. I was going to go on to say, as I did in my remarks, that I have no problem—in fact, strongly support—setting some targets.

When the United States started the framework talks and negotiated the original framework agreement last summer, it put very

high priority on getting a quantitative target for reducing Japan's global trade surplus. The United States put forward to the Japanese a proposal to reduce their surplus, as I suggested in my remarks, to 1.5 to 2 percent of their GNP. That, in fact, was one of the major demands and sticking points in coming to the original framework agreement.

The Japanese just would not buy it. Finally, they settled on some words, something like "a substantial reduction in Japan's global surplus." The United States then immediately said publicly, "We interpret that to mean lowering it to 1.5 to 2 percent."

I think that is the alternative way to do it. If the Japanese will not agree—and I agree with you, in some of these areas, they should—we then simply have to indicate what our expectation is and head toward that result.

On the macro target that we are now discussing, I suggested in my remarks that there is in fact quite a good chance of achieving that result through changes in the big picture economic variables. I have charts in my book, and I can discuss that ad nauseam with anybody you would like, showing that the exchange rate pays off dramatically.

The relationship between the exchange rate of the yen, versus all currencies, and Japan's global surplus is just like this over the last 15 years. Every 1-percent rise in the value of the yen cuts Japan's global surplus by $3 billion to $4 billion over a 2-year period. Every 1-percent rise in the yen exchange rate against the dollar cuts their bilateral surplus with us by $1 billion 2 years out. As I mentioned, it even cuts, on a totally predictable scale, the auto position relative to the United States and Japan in the United States market.

I am pretty confident that with the yen having risen to the level it has, if we keep it there, and if Japan will take the domestic stimulus measures that I listed, then we will achieve our target on the external side.

Mr. SPRATT. But all things being equal, it is better to have a strong currency because you can buy products in the world markets and buy assets in the world at favorable exchange rates.

Mr. BERGSTEN. Absolutely.

Mr. SPRATT. So the optimum objective is to balance your trade at high exchange values favoring your own currency. It is a suboptimal strategy, is it not, to opt for much lower, significantly lower, exchange values. If it has to be, it has to be. In fact, that is part of the automatic adjustment process. But all things being equal, you would prefer to see a settlement of your international accounts at the highest exchange rate achievable.

Mr. BERGSTEN. In fact, one objective of a country's economic policy should be to support a strong currency. Here, the United States is lucky. People do not realize this. Over the last year or 18 months, take any recent period, the dollar has risen in value against every currency in the world except the yen. The dollar is not a weak currency.

The headlines you sometimes read about the weakening dollar are very misleading, because it has dropped only against the yen, and that is to correct this big Japanese surplus. The trade-weighted dollar, if you average our dollar against all other currencies, is

up substantially over the last year, particularly over the last 18 months.

No one could at this point say the United States is either suffering from a weak dollar nor pursuing a weak dollar. In fact, the dollar has been strong. It is just that the yen has been stronger, and rightly so, given the huge Japanese surplus and competitive position.

Mr. SPRATT. Mr. Horn.

Mr. HORN. Thank you very much, Mr. Chairman.

Does not a strong yen also increase the dollar value of imports and thus worsen the trade balance?

Mr. BERGSTEN. One of the objectives, as I said, of the stronger yen is to increase the price of imports and thereby improve the relative competitive position of American sellers in our domestic market. We will have to pay more for imported products. Therefore, we will buy more from the domestic producers, and that is part of this adjustment process.

In the short run, that is, the next few quarters, the higher price for Japanese products does tend to dominate the volume reaction. So the trade deficit will rise a modest amount. This is the so-called J curve. It gets a little worse before it gets better. Once you get three or four quarters out, then the shift in sales to the domestic firms comes to dominate. If our goal is to get our trade deficit down, increase jobs, and expand our competitive position, then it works, and the data show it works.

Mr. HORN. Let me try another one. You mentioned the exchange rate and the relative value of their yen and our dollar, that we are strong but they are stronger. The yen has declined from 250 per dollar in the early 1980's to about the 100 or 110 we are talking about today. That is about a 60-percent devaluation. If that devaluation will not cure the trade deficit, what dollar/yen exchange rate will?

Mr. BERGSTEN. I pointed out in my comments the devaluation did largely cure the deficit, but then it was allowed to go the wrong way again. Let me repeat what I said.

The yen was enormously undervalued at 250, which was at that time, frankly, the flip side of the fact that the dollar was enormously overvalued. In the first 5 years of the Reagan administration, you will all recall the dollar skyrocketed, not just against the yen but against every currency. That produced the huge rise in America's trade deficit, which hit a record peak of $160 billion in 1987.

It was our allowing the dollar to price us out of world markets, getting way out of line with our underlying competitive position, that converted us in 2 years from the world's biggest creditor country to the world's biggest debtor country. It was a disastrous American policy. Part of the problem was that the yen became way undervalued. There was a huge amount of water in the exchange rate, so to speak.

The yen had a long way to go to get back to a competitive position. In fact, the yen doubled in value from 1985 to 1987, from 250 yen to the dollar to 120. What was the result of that? I mentioned it before. Japan's global surplus came down from 4.3 percent of its GNP in 1986 to 1.1 percent in 1990. Now it has gone back up. Why

did it go back up? Because instead of keeping the yen at 120, as it was at the end of 1987, it was permitted to return to 160. That, combined with the recession in Japan, triggered this enormous increase again in their surplus.

I could show you the charts. The correlation works in both directions: A stronger yen, much lower Japanese surplus; a weaker yen, renewed rise in the surplus. Now we have a much stronger yen again. If we could hold it, the surplus will clearly drop again by a substantial amount.

Mr. HORN. One of the ways we could reduce this trade surplus imbalance situation with Japan is to permit Alaskan oil to be sold in Japan. How do you feel about that?

Mr. BERGSTEN. In an earlier book I did on the topic, I strongly recommended that step. The United States has shot itself in the foot in a number of respects with our trade.

My institute published a study about 6 months ago, showing that we have been choking off our own exports in total by as much as $30 billion to $40 billion a year, with a combination of export controls, foreign policy sanctions, inadequate export credits, and the like.

We often talk about how foreign barriers block our exports, and they do. My studies show that is true in the case of Japan. But we have been shooting ourselves in the foot with our own policies. One angle to that is the Alaskan oil embargo. That could generate several billion dollars of additional United States exports to Japan.

Mr. HORN. What do we mean by "several"? Five billion, two billion?

Mr. BERGSTEN. At the time we did the detailed analysis in the late 1980's, it was on the order of $4 billion to $6 billion.

There is an important caveat though. If the United States exported that amount of Alaskan oil to Japan, there would have to be some offsetting import of oil from somewhere else. That would be a smart thing for us to do in any event, because you would save transportation costs, you would sell to a nearby market, and we ought to do it.

The point is, the step would sharply reduce our bilateral imbalance with Japan by about the amount indicated, say $5 billion, but it would not reduce America's global trade deficit by a similar amount. In fact, it would probably reduce it by, say, $1 billion or so because of the price differential.

This is a good illustration of why we need to focus on the global trade positions of countries, rather than the bilateral relationship. If we just focused on the bilateral position, we could fool ourselves into thinking we were doing more for the overall outcome, American jobs and the like, than we actually were.

Mr. HORN. Of course, there is another outcome to that. That is, if Alaskan oil stops flooding southern California, the California domestic oil production might be revived, and you would not have to import from the Middle East. In which case, it is a plus.

Mr. BERGSTEN. You are absolutely right. If the net result of selling to Japan were an increase in United States domestic output, whether in California or Alaska or anywhere else, then we could get a net gain. Most experts who have looked at it are not sure you would get too much of that result, but that would be the best out-

come. Then you could get a net gain for the aggregate position as well.

Mr. HORN. Let me ask you, based on your analysis of United States-Japanese trade and your sense of the global markets, has the Japanese Government ever agreed to opening its country to any major line of U.S. goods without pressure from our government? Can you think of a case where they did it without pressure from the American Government?

Mr. BERGSTEN. Like President Eisenhower once said, when asked a very different question, "Give me a week and maybe I can think of an answer."

Mr. HORN. I remember the question and the circumstances.

Mr. BERGSTEN. I do not have one at the forefront of my mind. As I said in my remarks, it has been sad but true, that gaiatsu has seemed to be required. It has been of different degrees. When I was running the international part of our Treasury Department, I was able to work things out with Japanese counterparts without a lot of publicity and public threats of retaliation and all that. But, without the U.S. initiative and effort, marketing opening was unlikely.

Japan has seemed to be constitutionally unable to come forward with initiatives that should help its own people. The new Prime Minister has said that is his intent: To deregulate, to liberalize, to push toward a consumer society. Those are the right words. If he would do it, it would be terrific. If we could find a way in these current negotiations to essentially ally with him in achieving his stated objectives, then we would have the best of all possible worlds.

Mr. HORN. Let me ask you about another angle on this, and that is Japanese-owned firms in the United States. As I recall, Mickey Kantor said before the recent summit that they would not discriminate against any foreign "transplants"—in other words, foreign-owned firms in the United States—from any country. Yet, the claim is made that the U.S. policy is to discriminate against Japanese-owned transplants in the United States. Is that claim accurate or inaccurate?

Mr. BERGSTEN. As far as I know, it is inaccurate. I have heard that claim in Japan as well. I have never heard any basis for it. The United States has a longstanding policy of national treatment for all foreign firms here. I have never been aware of any cases where that has been violated, in the aggregate or in terms of Japan. I think that is probably correct.

We published a major study at my institute a couple of years ago, and we have updated it, called "Foreign Direct Investment in the United States," where we took a look at the economic impact on the United States of the Japanese transplants here. We compared the economic effects of the Japanese transplants with American firms and with other foreign firms in the United States, across a whole range of indicators.

On most criteria, we found a very similar outcome. The Japanese firms seemed to spend as much on R&D here per unit of output as America and other foreign firms, seemed to have as much value added, and seemed to produce as many jobs. There was one huge difference, and that was on trade. The Japanese transplants imported something like six times as much, as a share of their total

sales, as the American firms and two to three times as much as the other foreign firms.

It could be that because the Japanese firms are new, they are still relying on suppliers at home, and they will be increasingly turning to local content. We hope so. That has been the pattern of other foreign firms. But that does raise a question, and it gets into that thought I mentioned before of bringing antitrust cases to make sure that their procurement is in fact open.

Mr. HORN. One last question, Mr. Chairman. That is, you mentioned the success of GATT when we took issues to them. Should there be any alternative dispute solution systems with Japan, or with other countries that might someday come into that position, that we ought to be thinking about now? If so, what are they, besides GATT, besides bilateral jawboning, as you would say in labor relations? Anything else?

Mr. BERGSTEN. There are two important ones. One is to recognize that the recently completed Uruguay Round in the GATT has substantially improved the dispute settlement mechanism in the international body. That has been a source of frustration to us in the United States for many years. I think one of the major accomplishments of the Uruguay Round was to improve it. Congress, of course, will be voting on the Uruguay Round package in the next few months, I hope; and I would strongly urge you to support it, in part because it will give us a better dispute settlement mechanism, including in cases like this.

The second one that is only in a beginning stage but could become important is the APEC, the Asia-Pacific Economic Cooperation forum. Remember that President Clinton hosted the first-ever summit meeting of the Asia-Pacific countries at Seattle in November. The whole idea is to start transforming that regional mechanism, which has only been an annual meeting and a bunch of low-level working groups so far, into a meaningful economic institution, including as a dispute settlement mechanism that could help deal with regional disputes.

I think the Japan case is a perfect one for looking to APEC over time for some help because every other country in the region ought to be supporting U.S. objectives. The other Asians know, even better than we, how hard it is to get into Japan. They know, even more than we do, how Japan's big trade surplus exports unemployment to them. Korea has a huge structural deficit with Japan that is much bigger than ours relative to the size of its economy, and so do most countries in the region.

So if we can develop a meaningful regional mechanism for dealing with some of these issues, we would have many allies around the table, including allies that are in Japan's own backyard that they have to worry about, in addition to worrying about us. I think it would help our negotiating position.

Such a mechanism will never substitute for bilateral efforts, but it could complement them in an important way, and it could also help us take that very important moral high ground that I talked about before and that somehow we have lost now. Most of those Asian countries are opposing our effort with Japan, whereas they ought to be supporting it.

Mr. HORN. I wonder, Mr. Chairman, if at this point in the record, your staff could get a summary of those two different dispute mechanisms, both GATT and the new Asian regional one?

Mr. SPRATT. If you have that, it would be helpful if you could submit it for the record.

Mr. BERGSTEN. I would be happy to. I am sure the administration in submitting the GATT package has given you chapter and verse on that. The APEC one is at a very early stage. A group that I chair that has proposed a strategy for developing APEC in this direction has laid it out. I would be very happy to submit that to you.

Mr. SPRATT. That would be useful to have.

Let me, at this point, recognize the presence of our chairman, John Conyers, and ask him if he has any statement he would like to make or perhaps a question. I know, Mr. Prestowitz, he has a question or two for you when you come around, but we may want to take your statement before we open you up to questions.

Mr. CONYERS. I am always glad, Mr. Chairman, to see Clyde Prestowitz. He has graced our hearings before, and I am very interested in Mr. Bergsten's comments.

I commend you. You are continuing the hearings that Doug Barnard had on this subject. It is very important, and I have a statement for the record.

[The prepared statement of Mr. Conyers follows:]

Statement of Rep. Conyers

- President Clinton was right on target when he told his advisors before the summit with Prime Minister Hosokawa that he wanted to take a "no nonsense" approach to ensuring progress in the trade talks. After 29 trade agreements since 1980 have failed to reduce Japan's $50 billion trade surplus with the United States, an agreement that does not set quantifiable goals simply will not work.

- When Japanese auto manufacturers gain 30% of the American consumer market but the low-cost, efficiently produced new autos and light trucks coming out of Detroit are able to export to the United Kingdom, Germany and Saudi Arabia but are restricted to 0.46% of the Japanese market, tough talk must be replaced by tough action.

- When Japanese trade barriers such as tariffs, quotas and restrictive regulations limit Japanese imports by $9-$18 billion (as estimated by the Congressional Research Service), and when you realize that each billion dollars in lost exports means fewer American jobs, the importance of today's hearing becomes clear in a meaningful way.

- Removing the barriers and thereby increasing American exports could result in 171,000 to 342,000 new jobs (CRS says that $1 billion in exports creates 19,000 jobs.)

- So, I commend Chairman Spratt for scheduling this important hearing and look forward to the testimony that will comment on further steps the United States should take now that the talks have broken down and the President has announced his intention of seeking punitive measures against the Japanese for barriers in the telecommunications area.

- My interest is principally in ensuring that the Big Three auto makers from Detroit get a fair shake when it comes to opening up access to Japanese markets and selling spare parts for Japanese companies that sell in the United States.

- Let me add that I am seriously studying the legislation sponsored by Majority Leader Gephardt which would mandate progress towards specific quantifiable goals. This is a worthy measure that should prod the negotiators towards getting some agreements that can reverse the deplorable imbalance that now characterizes trading relations between the two leading economic powers in the world today.

Mr. CONYERS. We have a G–7 global jobs conference with the ministers coming up in Detroit. The President thought he would like these ministers to see the real world of the industrial sector, rather than perhaps a golf club setting.

I was wondering if you have any hopes that we may do more than the ministerial exchange of papers that always accompany these high diplomatic type conferences. Could we possibly begin to examine the whole problem that we are having throughout the world? The recession and the question of creating meaningful jobs is hitting most of the G–7 countries. I would like to see what kind of comment you have about that.

Mr. BERGSTEN. I would certainly hope they would do more than exchange papers. As I understand it, the objective is to look at some of the structural causes of unemployment and share national experiences.

There is a fascinating paradox here. The rest of the world, certainly the Europeans, look to the United States as having been a great success in creating jobs. As you know, over the last 20 years, the United States has created something like 40 million new jobs. The Europeans have only created 2 or 3 million new jobs. They look at us as the paragons.

The problem from our standpoint, of course, is that one way we have done it is through keeping wages down. Our average annual wage today is lower than it was 20 years ago; in Europe, it is 60 percent higher. The Europeans have essentially raised the salaries of those who work, let their unemployment rates go up from 2 to 12 percent, channeled income from employed people through big government welfare systems to the unemployed and kept them off the streets. We made a different social choice. We have created jobs partly by keeping wages down.

Having said that, we, too, have a structural job problem. I think one thing the G–7 summit can do is help us learn from some of the job training and education programs in other countries, such as Germany and the Scandinavians countries, which have been demonstrably successful and where, as you know, we have not done a very good job. We need to pick up some of their experience, and they are going to need to pick up on some of our experience.

To go to today's topic directly, in addition, I would point to another G–7 meeting. There is one coming up in Germany this weekend of the finance ministers. I think they ought to do what I was saying to the committee at the outset and before you came in, Mr. Chairman. They ought to hammer Japan for exporting unemployment to the rest of the world.

This is what Japan is doing by running a trade surplus of $140 billion. Japan is keeping its domestic production and jobs up, not by selling to domestic consumers but by selling to foreign consumers—in other words, exploiting foreign demand rather than creating its own demand.

Secretary Bentsen and the U.S. representatives in this weekend's G–7 ought to be hitting the jobs issue in that way very hard by insisting that Japan take steps to boost its domestic growth and stop exporting unemployment.

Mr. CONYERS. Clyde Prestowitz, I know you have not testified yet. I am going to be running between several committees. Did you

have an observation about this whole matter that we are discussing?

Mr. PRESTOWITZ. I think that, as Fred Bergsten said, the jobs summit is a good place to exchange national experiences and see what one can learn from what is happening some place else. In all honesty, I doubt that it is going to result in substantial changes in the current situation, either here or elsewhere.

I think that the European jobs problem stems from a deep seated structural problem within the European economy, plus the fact that the Europeans are facing the brunt of the burden of integrating Eastern Europe and the Soviet Union into the world economy. That causes great structural difficulties for them.

Second, we just had a summit conference between the President and the Prime Minister of Japan in which, essentially, the Japanese said, "We are not going to do anything differently." As Fred said, they are now exporting unemployment, and they effectively have said, "We are not going to stop doing that." Moreover, domestically, what is even more astounding is the Japanese Government has taken a position with regard to its domestic policies that it is not even going to stimulate its domestic economy very much.

It does not seem that there is really a great concern with this issue in Japan. Given that it is the second largest economy in the world, it is hard to see how the problems are going to be solved unless you get some cooperation there.

I would go along with Fred and urge that the U.S. Government and the other G–7 countries put maximum pressure on Japan at the next meeting and at the jobs conference in Detroit, but I do not think that we should have inflated expectations of what might come out of the jobs conference.

Mr. CONYERS. Are there any long-term fixes for the auto industry and the trials and tribulations we have endured for a couple of decades over there in regard to your looking into where we are going from here?

Mr. PRESTOWITZ. For the U.S. auto industry, I think that there are some good prospects. First, as you know, the Big Three have dramatically improved their productivity and their cost basis and are now among the lowest cost producers in the world. They are gaining market share in the United States. I think they should continue to do that, and I believe they will gain in export markets. Particularly Ford and Chrysler are becoming very aggressive in export markets.

What is even more promising or offers more potential are the so-called transplants, the Japanese and now the German companies that are or will be producing in the United States. The Japanese transplant producers, at the moment, continue to have a very high percentage of Japanese parts and materials in the cars they make in the United States. This makes them high-cost producers. Both in their own economic interest and in response to the pressure of the U.S. Government, these companies should be moving to increase the North American content in their U.S.-based production.

The Japanese auto companies are all on record as saying that they would like to hit a level of 75 or 80 percent North American parts, materials, and labor. At the moment, we calculate that they are somewhere between 40 and 50 percent. If they would hit their

own targets, that all by itself would have an impact in the area of $20 billion on the trade relationship.

So I think that the U.S. Government should put enormous pressure on them to move to hit their own targets. I think that for the U.S.-based auto industry there are very good prospects.

Mr. CONYERS. I hope this sits well with Andy Card's testimony, who is coming up on the next panel. We are skipping around, and I appreciate it. If I could just get a reaction from Mr. Bergsten, I will have completed.

Mr. BERGSTEN. I would add one important point to that. I mentioned it before you came in, but it is worth elaboration. I think Clyde is right that the outlook for the U.S. auto industry in its competition with Japan is quite promising now. The underlying change in competitiveness of the auto sector makes that possible.

In addition, a big gain to our auto companies comes from the strong exchange rate for the yen. That significantly hurts the competitiveness of the Japanese suppliers selling into this market from Japan, both final autos and auto parts. That reinforces and maybe is the main driving force in raising the local content of the Japanese producers.

I mentioned before, I had a chart in the recent book I published on United States-Japan trade, showing an almost precise correlation between the yen/dollar exchange rate and the share in the United States auto market of United States versus Japanese companies. The companies know it very well. When the CEO of General Motors made his yearend statement a few weeks ago, he cited as one of the three major elements in GM's recovery last year the strong exchange rate for the yen.

That is the most important policy element that the U.S. Government can provide for Detroit—make sure the yen stays strong and affects the price competitiveness in an industry that, as you know, is very price sensitive. Reinforced by these targets that the Japanese companies have talked about, the market pressure from the exchange rate change clearly does push them to more local content, and that of course is where the big money is in changing the trade balance in the auto sector.

Mr. CONYERS. I thank you both very much.

Mr. SPRATT. Thank you, Mr. Chairman.

Mr. Shays, let me ask you to direct your questions to Mr. Bergsten, keep it to the point, and then we will have another opportunity for questions of both.

Mr. SHAYS. I would be happy to have Mr. Prestowitz testify and then question them both, if you would like me to do that.

Mr. SPRATT. Then we will come to you first on questions of the whole panel.

Mr. Prestowitz, welcome. I do not know whether you have prefiled testimony or not.

Mr. PRESTOWITZ. Yes, I did submit a statement. I will be very brief.

Mr. SPRATT. We will make it part of the record, if there is no objection, so that you can summarize it and proceed in any manner you wish.

## STATEMENT OF CLYDE V. PRESTOWITZ, JR., PRESIDENT, ECONOMIC STRATEGY INSTITUTE

Mr. PRESTOWITZ. I apologize, Mr. Chairman, for being late. I got caught in an enormous traffic jam around the White House. I will be very brief.

The overwhelming evidence of all the studies that have been done by my institute, by Fred's institute, by scholars at Harvard and Brookings and other institutes indicates that Japan is a special case in the trading system. It is an outlier. Its ratio of manufactured imports, compared to GNP, is far lower than that of all other developed countries.

There is great debate and discussion about what are the causes of that. They range all the way from the explanation that American companies do not try hard enough to the notion that the Japanese are somehow unfair.

There are four or five arguments that are typically adduced to explain what is going on. One of them is the argument that it is merely a savings and investment imbalance. The Japanese save a lot, and the Americans do not save much; therefore, we are bound to have a trade deficit and they are bound to have a trade surplus.

While that argument is true on a global basis—that is, low-saving countries tend to have global trade deficits and high-saving countries tend to have global trade surpluses—that has very little, if anything, to do with bilateral balances. Indeed, it is also the case that savings rates are influenced by trade behavior. That is, in the equation, because it is an equation, the action in the equation can go in both directions.

If there are trade barriers in a particular country, and you are not able to sell in that country, that obviously lowers the profits that your producers can make, it reduces the taxes that they pay, and it has a negative impact on domestic savings.

When you look at the pattern of Japan's trade, you find that Japan has trade surpluses with everyone. It has trade surpluses with countries that have a higher savings rate than it has. It has trade surpluses with countries that have a lower savings rate than it has. In the case of Japan, the savings-and-investment argument is a very uncertain guide to prescription or to behavior.

A corollary of this argument is that what we need to do is to reduce the U.S. budget deficit; that is the surest way to reduce the United States trade deficit with Japan. We, at our institute, have done a series of regression analyses to determine whether there is any correlation between the U.S. budget deficit and the United States/Japan trade deficit, or indeed if there is any correlation between any country's budget deficit and its deficit with Japan. We have found zero correlation.

Another argument is the exchange rate argument. While it is true that the exchange rate has a powerful effect on trade and on trade balances, it is also true that the exchange rate seems to work less well with Japan than with anyone else.

In the 1980's, when the United States trade deficit soared, not only with Japan but with the European Community and our other trading partners, we saw a rapid and significant adjustment as soon as the dollar began to devalue. We saw the United States go from a $20 billion trade deficit to a substantial surplus with the

European Community in the years 1987 to 1989. Our trade turned around with most of our other trading partners.

In the case of Japan, our trade deficit was reduced from $50 billion to about $40 billion, nothing like the effect that the exchange rate had with any other trading partner.

A final argument that is used is to say the Japanese have to stimulate their economy. If they would just stimulate their economy, this would suck in imports and reduce their trade surplus and reduce their bilateral surplus with the United States. Again, stimulus of their economy would be a good thing, and it would have some effect.

I was thinking, as I was listening to the response to one of Mr. Horn's questions, when Mr. Bergsten pointed out that the Japanese trade surplus had been reduced from 4 percent to about 1.1 percent of its GNP, that occurred in the late 1980's at a time when Japan was experiencing one of the historically great bubbles, comparable to the South Sea bubble and the tulip mania in Holland.

This was a kind of stimulus to the Japanese economy, the likes of which very few countries have ever had. Yes, it did reduce Japan's trade surplus but not by very much. You had the yen being doubled in value. You had an unbelievable surplus to the Japanese economy. Yes, the surplus came down but not by anything like what you would expect.

The reason for this is because in Japan, there was what economists call "elasticity of demand." The propensity of the Japanese to import is extremely low. It is less than one-half that of the United States and about one-half or two-thirds that of Europe. This means that in order for the stimulus to work on Japan's trade surplus, it has to be enormous. Believe me, you will never have again in Japan, at least for a long time, anything like the stimulus of the late 1980's, and that did not really remove Japan's trading surplus.

It means that for the exchange rate to work, you have to have an extremely strong yen. Based on current elasticities, the analysis that we have done indicates, in response to Mr. Horn's question, that you would have to have a yen somewhere in the 50 to 60 yen per dollar range to achieve something like balance in trade between the United States and Japan.

Of course, the exchange rate works, but it is a very blunt instrument. It means, on the one hand, not only does it raise the cost of Japanese goods, but it makes it impossible for outsiders to invest in Japan. It actually makes it more difficult to penetrate the Japanese market.

I am on the board of a small high technology company that is now trying to penetrate the Japanese market. We desperately need to station a couple of executives in Tokyo. Do you know what it costs to station one executive in Tokyo these days in dollars? It is over a half-million dollars. This is not trivial for a small high-tech company.

So the exchange rate is a tool. If that is the only one you have, then, for sure, use it. The real problem here is the structure of Japanese trade and the structure of the Japanese economy, which is the factor that results in this low propensity to import, and it is also a factor that contributes to this very high savings rate in Japan.

The only way fundamentally to address the United States-Japan problem—and as Fred points out, it is not just a United States-Japan problem; it is a Japan/Korea, Japan/European Community, Japan/Singapore, Japan/Hong Kong, Japan/Taiwan problem as well. The only way to fundamentally address that problem is to achieve a change in the pattern and the structure of the trade and of relationships in the Japanese domestic economy. That can occur only through deregulation and reform, through reform of the Japanese economy. All of our experience tells us that it is unlikely to happen without the exertion of significant pressure, consistently and constantly, by the United States. Thank you.

Mr. SPRATT. Thank you very much, Mr. Prestowitz.

[The prepared statement of Mr. Prestowitz follows:]

# TESTIMONY OF CLYDE V. PRESTOWITZ, JR.
# PRESIDENT
# ECONOMIC STRATEGY INSTITUTE

Before the House Government Operations Committee
February 24, 1994

Mr. Chairman, earlier this month, the Economic Strategy Institute published *Making the Framework Talks a Success*. The report examined Japan's trading patterns. Today, I would like to take a few minutes and discuss the study's findings with the Committee.

- Japan has run large trade surpluses ever since the early 1970s. These have persisted despite
  --major changes in the Japanese economy
  --sharp fluctuations in economic growth rates in the United States and other foreign markets for Japanese goods
  --shifts in exchange rates
  --variations in financial markets
  --numerous bilateral and multilateral negotiations designed to address trade frictions with Japan.

- The Japanese trade imbalance is structural, and results primarily from an extremely low level of manufactured imports relative to other industrialized countries.

- Based on econometric analysis and industry data
  --the shortfall in total Japanese imports exceeds $200 billion annually
  --more than $50 billion would come from the United States
  --the shortfall is not caused by standard economic factors, but by other factors which keep Japanese markets closed
  --Japanese imports are lowest in major Japanese export industries.

- It has become increasingly important that Japan's global trade surplus be reduced because
  --the surplus is depressing economic activity in the United States and other countries
  --it is harmful to high value-added industries in the United States and elsewhere, thus holding down average productivity and wages, research and development, and future economic growth
  --it could lead to even greater trade friction in the future, jeopardizing the global trading system.

- A major opening of Japan's markets to U.S. exports would benefit the U.S. economy by
  --raising U.S. GNP by 1 to 2 percent
  --creating 1.5 million U.S. jobs
  --reducing the trade deficit by $35 billion annually
  --reducing the budget deficit by $35 billion annually
  --raising national savings by 1 percent.

- A substantial restructuring of Japanese markets would also generate benefits for Japan.
  --It would substantially slow inflation.
  --Real wages would rise.
  --It would lower Japan's extremely high personal saving rate.
  --It would prevent potential backlash from other countries that could limit Japanese growth in the future.

- The conventional view that the problem can be solved only by macroeconomic measures is misguided.
  --The problem is structural, not the result of macroeconomic forces.
  --Macroeconomic policies will thus produce only limited trade-related results.
  --These measures would also have major adverse economic side effects.

- Additional U.S. budget deficit reduction would have a negligible effect.
  --It incorrectly assumes that the U.S. trade deficit with Japan is caused by U.S. budget deficits and low saving rates.
  --it does not address the real problem-- namely, Japan's low import ratios.

- Relying primarily on exchange-rate management is inadvisable because
  --the yen would have to double in value to halve Japan's trade surplus
  --it would harm Japan's most efficient industries rather than those that are protected
  --it would create pressure on inflation and interest rates in the United States
  --intervention cannot always influence currency markets.

- The proposed 15 trillion yen economic stimulus package in Japan is needed to fight the current recession, but
  --it would increase Japan's total imports by only about $10 to $28 billion (Japan's 1993 current account surplus was $130 billion.)
  --it would raise U.S. exports to Japan by only $2 to $6 billion (Japan's 1993 bilateral trade surplus with the United States was $60 billion.)
  --it would not raise Japan's unusually low import ratios.

- Efforts aimed at raising Japanese import ratios closer to levels in other OECD countries must therefore accompany macroeconomic measures.
  --Everything else has been tried and failed.
  --The use of objective criteria to measure progress is essential.
  --They do not require market share arrangements.

Mr. Chairman, this analysis leads to one inescapable conclusion. Bringing about major import expansion in Japan is essential. But doing so will require a new negotiating framework. It will also require concrete steps by the United States

and Japan to bring about the needed structural changes in Japan that will result in a significant opening of Japan's market to imports. At the same time, these measures must be consistent with Japanese norms and practices if they are to be effective.

A results-oriented approach fits these requirements and offers the best chance for success. For many years, the Japanese have based their economic policy and their economy's structure on quantitative goals for output, exports, research and development, jobs, etc. for many key industries. As a result, Japan is accustomed to setting targets and then developing policies designed to achieve those goals.

**What Can Japan Do?**

- Because agreements on procedural issues have achieved little measurable success in the past, the Japanese government should agree to monitor import expansion efforts with quantifiable indicators. A results-oriented trade policy does not require market sharing arrangements on a product by product basis. Rather, Japan must commit to increase the level of foreign participation in its economy and closely monitor import expansion efforts. Indicators could include the number of dealers carrying foreign products, the level of administrative approval required to start a business in Japan, and the number of inspections required to import products into Japan.

- Prominent Japanese political leaders and bureaucrats, including Minister Hiroshi Kumagai of MITI, have admitted that Japanese companies collude to keep imports out of the domestic market. The Japanese government should agree to eliminate collusive behavior in the Japanese economy. For example, the government could vigorously enforce anti-trust laws (especially in cases where imported products are involved), de-charter trade associations with bylaws that impede foreign penetration, and increase the capacity of foreign and domestic entities to challenge collusive behavior in court.

- The Japanese government, as part of its economic vision, should promote the creation of an open Japanese economy. Long term industry-by-industry forecasts should project greater foreign participation rates in the domestic economy and encourage greater utilization of foreign inputs.

- To set an example for the private sector, the Japanese government should end the practice of favoring domestic products in public procurement and support competitive imported goods.

- The Japanese government should increase spending for promoting and advertising imported goods and services.

- The Japanese government should continue to deregulate the domestic economy. Japanese ministries for years argued that the domestic economy was not over-regulated, but recent statements by politicians and businessmen indicate that regulations are holding down import levels in Japan. Deregulation would facilitate import sales by improving market access of foreign goods and by increasing the availability of imports for consumers in Japan.

- The Japanese government should adopt policies designed to increase foreign direct investment (FDI) in Japan significantly. The stock level of foreign direct investment in Japan, 0.5 percent of GDP, is minuscule in comparison with the OECD average of 12 percent. This discrepancy is important because foreign investment will make it easier to achieve the import targets. Since the Japanese government is a major landowner, it has the capacity to donate or lease land at low cost to foreign corporations that want to invest in Japan. The government should also provide tax incentives to help overcome the high cost of establishing facilities in Japan, subsidize the cost of insurance on foreign-owned or leased property, and reduce the tax burden on foreign nationals. Most important, the government should utilize the network of public and semi-private organizations that facilitate outward FDI to facilitate inward FDI. These agencies typically provide cut-rate insurance, low-cost financing, and feasibility studies for Japanese companies that wish to invest overseas.

- The Japanese government should provide both tax incentives for Japanese distributors carrying foreign products and other incentives to increase the purchases of imports by Japanese companies.

- The Japanese government should enact and implement stimulus measures. Fiscal expansion is needed now to lift Japan out of its current economic malaise and in the future to help the government offset the effects of higher import levels. A stimulus package, however, should not be viewed as a long-term solution to the trade problem because fiscal policy does not deal with the structural barriers to imports.

- The Japanese government should avoid weakening the yen to spark an export -led recovery. The Ministry of Finance should also consider making the yen a reserve currency.

**What Can the United States Do?**

- U.S. policymakers should work closely with U.S. industry leaders--especially those who have firsthand experience with the obstacles to market

access in Japan--to formulate a comprehensive and coordinated strategy to enter the Japanese market. Government and industry might first focus on evaluating the global competitiveness of U.S. products.

- When addressing the adverse effects of Japanese trading patterns, the U.S. government should make sure that its policies are consistent across federal agencies and bureaus. If the goal of the U.S. government is to close the trade gap with Japan, it should seriously reconsider policies that indirectly subsidize Japanese exports to the United States.

- The current administration must start a full-court press to increase the incentive for the Japanese to negotiate seriously with the United States. Given the political environment and stagnating economy in Japan, U.S. negotiators have an unprecedented opportunity to open the Japanese market to U.S. imports and investment. To overcome bureaucratic intransigence, the U.S. government must employ a multi-level approach to U.S.-Japan trade negotiations. Negotiators must extend their reach to other players in Japan, including industry leaders, potential importers, citizen's groups, and politicians.

- The administration should tell Japanese companies directly that major, concrete progress is expected of them, particularly those who have benefited from America's openness. The Japanese auto companies, for instance, have all said publicly for many years that their objective is 75 percent U.S. materials and labor content in their U.S. manufacturing operations. Most of them, however, are still not close to that level. The Japanese auto companies should reach their own domestic content targets. (Since the Japanese auto companies are all currently losing money, and since U.S. parts are often much less expensive than Japanese parts, there seems to be good reason for them to do so.)

- Periodic calls and visits from top administration officials inquiring about Japanese companies' progress would send a direct signal to Japanese industry that the United States has at last gotten serious. The Japanese government engages in such activity constantly, but no U.S. administration has ever done so.

- The U.S. government should work to develop allies among other countries this have experienced similar problems with Japanese trading patterns.

- The U.S. government should strongly enforce existing anti-trust and tax laws that apply to Japanese companies operating in or exporting to the United States to ensure that they are in compliance with U.S. laws.

A new approach to the U.S.-Japan trade imbalance that combines macroeconomic measures with a results-oriented approach is needed to increase imports and reduce the huge Japanese trade surplus. Expanded Japanese imports will raise global economic activity, benefit Japanese consumers, and reduce the likelihood of trade-related conflicts.

A number of key charts from the study follow.

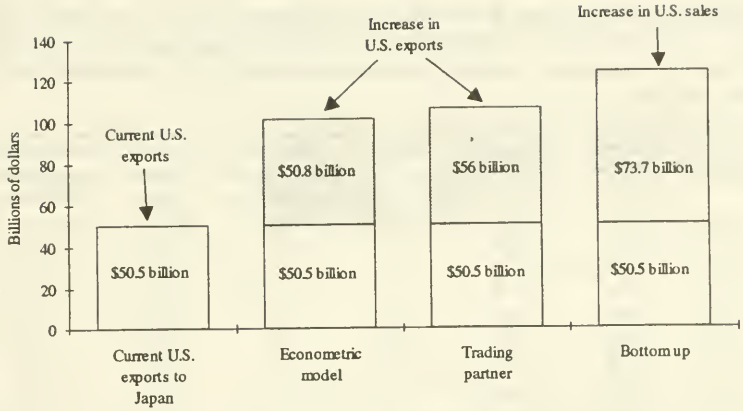
**1991 Imports and Exports as a Percentage of GDP, Selected Countries** Source: OECD/IMF data (Free on Board values) and ESI calculations

| Country | Exports/GDP (in percent) | Imports/GDP (in percent) |
|---|---|---|
| Japan | 9 | 6 |
| United States | 7 | 9 |
| European Union* | 9 | 10 |
| Canada | 21 | 21 |
| Australia | 14 | 13 |
| Austria | 26 | 29 |
| France | 18 | 18 |
| Germany | 26 | 24 |
| Italy | 15 | 15 |
| Switzerland | 27 | 29 |
| Spain | 10 | 15 |
| United Kingdom | 18 | 20 |

*Intra-union trade is excluded.

**Japan's Import Shortfall by Industry** Source: ESI--*Closing the Trade Gap with Japan*
A positive number indicates the shortfall. A negative number indicates greater imports than the econometric model predicts.

| Primary Goods | Shortfall (billion $) | | Secondary Goods | Shortfall (billion $) | |
|---|---|---|---|---|---|
| | World | United States | | World | United States |
| Agricultural commodities | -15.4 | -4.6 | Chemicals and related products | 25.4 | 9.1 |
| Beverages and tobacco | 3.0 | 1.4 | Simple manufactured goods (leather goods, wood goods, textiles) | 48.1 | 7.5 |
| Crude materials | -12.3 | -3.2 | Power-generating equipment | 10.5 | 6.0 |
| Mineral fuels and lubricants | -20.8 | -0.6 | Specialized industrialized machinery | 8.2 | 2.3 |
| Animal and vegetable oils | 1.3 | 0.2 | Metal working machinery | 6.8 | 2.1 |
| | | | General industrial machinery | 16.7 | 5.6 |
| | | | Office machinery and data processing | 16.5 | 10.4 |
| | | | Telecommunications | 10.0 | 3.4 |
| | | | Electrical machinery | 13.9 | 6.6 |
| | | | Road vehicles | 39.2 | 5.9 |
| | | | Other transport | 11.6 | 8.2 |
| | | | Miscellaneous manufactured goods | 41.5 | 8.7 |




**Potential Increase in U.S. Manufactured Exports to Japan** Source: OECD data and ESI estimates.

**Value Added by Industry** Source: Department of Commerce and ESI calculations.

| **Top four Japanese exports to United States** | **Percent of total exports** | **Value added per employee** |
|---|---|---|
| Office machines | 13.5 | $304,600 |
| Telecommunications | 10.1 | $195,300 |
| Road vehicles | 32.5 | $141,300 |
| Electric machinery and appliances | 9.9 | $120,000 |
| **Average Value Added** | | **$179,770** |
| | | |
| **Top four U.S. exports to Japan** | **Percent of total exports** | **Value added per employee** |
| Food and live animals | 16.1 | $114,100 |
| Crude materials | 13.2 | $85,700 |
| Miscellaneous | 11.3 | $77,000 |
| Chemicals | 11 | $324,000 |
| **Average Value Added** | | **$143,455** |

**Effect of a 2 to 3.2-percent-of-GNP Stimulus Package in Japan** Source: ESI estimates based on 1992 trade figures and exchange rate of 110 yen to the dollar. "Low" represents the 9 trillion yen stimulus package. *"High" estimates include the impact of a 6 trillion yen tax cut.*

| GNP Multiplier | Change in GNP (low) | Change in GNP (high) | Change in world exports (low) (billion $) | Change in world exports (high) (billions $) | Change in U.S exports (low) (billions $) | Change in U.S. exports (high) (billions $) |
|---|---|---|---|---|---|---|
| 1.1 | 2.1% | 3.5% | 10 | 16 | 2.16 | 3.56 |
| 1.2 | 2.3% | 3.8% | 10 | 17 | 2.35 | 3.88 |
| 1.3 | 2.5% | 4.2% | 11 | 19 | 2.55 | 4.20 |
| 1.4 | 2.7% | 4.5% | 12 | 20 | 2.75 | 4.53 |
| 1.5 | 2.9% | 4.8% | 13 | 21 | 2.94 | 4.85 |
| 1.6 | 3.1% | 5.1% | 14 | 23 | 3.14 | 5.18 |
| 1.7 | 3.3% | 5.4% | 15 | 24 | 3.34 | 5.50 |
| 2 | 3.9% | 6.4% | 17 | 28 | 3.92 | 6.47 |

**Long-term Effect of Exchange-Rate Changes on the Trade Balance***

| Yen appreciation (Percent from 1991 rate) | Long-run export supply elasticity | Long-run import demand elasticity | Exports (¥ billions) | Imports (¥ billions) | Trade balance after 4 years (1991 $ billions) |
|---|---|---|---|---|---|
| 0 | 0.21 | -0.67 | 42,360 | 31,900 | 78 |
| 10 | 0.21 | -0.67 | 43,250 | 34,037 | 68 |
| 20 | 0.21 | -0.67 | 44,139 | 36,175 | 59 |
| 30 | 0.21 | -0.67 | 45,029 | 38,312 | 50 |
| 40 | 0.21 | -0.67 | 45,918 | 40,449 | 41 |
| 50 | 0.21 | -0.67 | 46,808 | 42,587 | 31 |

Sources: 1991 exchange rate taken from *1992 International Financial Statistics Yearbook*. Export and import figures are from Japanese Ministry of Finance. Long run elasticities taken from Marcus Noland, 1989, "Japanese Trade Elasticities and the J-Curve," *The Review of Economics and Statistics* 71, no. 1: 175-79. According to Noland, the long-run effects are achieved after 16 quarters.

Mr. SPRATT. Mr. Shays.

Mr. SHAYS. Would the chairman like to ask a question first?

Mr. SPRATT. John, would you like to ask a question?

Mr. CONYERS. No. Thank you very much.

Mr. SHAYS. Mr. Prestowitz, you are responsible for one of the worst vacations I ever had in my life. We went to Nantucket. My wife and I both took a copy of your book, Trading Places, a few years ago. My wife would read it and she would say, "I don't believe this." I would read it and say, "I don't believe this."

I made the assumption that you had overdramatized it to sell your book. Then when I spoke to you later on, you said you had to tone it down because people would not believe it, which made me even less comfortable.

When I look at this issue, I see a lot on both sides that I can criticize. I see a tremendous amount of hypocrisy on the part of Americans who, in my judgment, think we can export without having to do the leg work necessary in some cases. I am grateful to the Japanese that they forced Ford Motor Co. to build a car that I like. I have two Tauruses. I do not think I would have them if the Japanese did not make quality cars. The first car I ever bought that I never had any problem with was a Honda.

I say this with a tremendous amount of appreciation for what the Japanese did, in terms of building quality, and I wish the United States had done that. I think, though, that we have used the Japanese as a benchmark and are making tremendous strides. I think Xerox today is a much better company because they benchmarked a Japanese product.

Having said that, I am fascinated that we have here today three broadcast companies—I make an assumption, based on the writing on their equipment—that are oriented toward Japanese-speaking audiences or are from Japan. I do not know. But it is amazing to me, there are no Americans here. If this is important to the Japanese, why is it not important to the United States?

It strikes me that while we were fighting the cold war, Japan and Europe were fighting an economic war and dividing the spoils. But now this is the war we are in, this contest. I am very excited about it.

Having said that, one of the issues I cannot get around is the fact that if the Japanese have a population that is roughly one-half our size, and the Japanese have a GNP that is roughly one-half our size, should we expect them to buy double the amount of product per capita to have a favorable balance of trade? Is it my expectation that there should be a clear balance? I would like to ask both of you that.

Mr. PRESTOWITZ. There does not have to be a balance.

Mr. SHAYS. Is it even realistic to assume that there would be? Why should the Japanese buy twice as much per capita from us as we buy from them?

Mr. PRESTOWITZ. Typically, small countries import a lot more than big countries. Typically, big countries have a more diversified economy and import less as a percent of their total production and export less. With a population twice as big as Japan's and an economy twice as big as Japan's, one would expect that the Japanese would be much heavier importers from us than we from them.

If you looked at this just from a blank page, the expectation might be that Japan would have a trade deficit with us. Typically, small countries have trade deficits with larger countries.

Mr. SHAYS. Define what you mean by "small countries."

Mr. PRESTOWITZ. We are twice as big as Japan.

Mr. SHAYS. Small industrial countries?

Mr. PRESTOWITZ. No, population.

Mr. SHAYS. Compare industrial countries. Is that typical in an industrial country that they would be buying twice as much?

Mr. PRESTOWITZ. Sure. If you look at the European countries, we have twice the population of Japan, and Japan has twice the population of Germany. If you look at the ratios of imports and exports, Germany's ratio of imports and exports to GNP are in the 20-percent range, Japan's are in the 10 to 12-percent range, and ours are in the 9 to 10-percent range. Typically, smaller countries, with smaller populations, with a less diversified economic base, are, on a proportionate basis, higher importers.

There is no rule that says that Japan and we have to have a trade balance. I think that we make a mistake when we focus too much attention on the size of the trade deficit. While I would like the trade deficit to come down, and I think it would under normal conditions of trade, I think it is very important—and this goes to a question Mr. Horn asked—to also look at the composition of the trade.

Mr. SHAYS. Let me ask Mr. Bergsten and preface it by also saying, I was intrigued by the fact that we wanted the Japanese to have a true balance while at the same time, we were building up a surplus with the Europeans. I was thinking, if we make that argument for the Japanese, then the Europeans can make that argument with us. It is a dangerous kind of game to be in.

Mr. BERGSTEN. Right. I argued very strongly in my opening remarks, I think before you came in, that we should not be focusing on the bilateral trade balance as our main indicator. We should be seeking a big cut in Japan's global surplus. That would, in turn, reduce the bilateral imbalance that we have.

Let me repeat a critical point of analysis. In two books I have done on this topic, the latest last summer, I took a very hard look at the bilateral trade position between the United States and Japan. I would argue that even if we had a complete balance in our global trade, and Japan had a complete balance—a zero balance in its global trade—Japan would still run a sizable bilateral surplus with us.

The reason is the triangular pattern of trade. Clyde was not quite right. The Japanese do not run surpluses with everybody. They run big deficits with Saudi Arabia, Australia, and Brazil and other countries from which they import primary products.

If they were going to run even a zero balance to offset that, they would sell their manufactured products to high-income industrial countries, such as ourselves and the Europeans. Our calculation in two studies is that even with global zero positions for both countries, the bilateral imbalance between the two would be about $30 billion or so, or one-half what it is now. It ought to come way down, but it would not be zero. We should not aim at that.

Having said that, I would advise looking at somewhat different indicators than you mentioned to see whether Japan is an outlier in terms of its import performance. For example, I would look at the share of imports in the domestic consumption of manufactures. That would correct for differences in resource endowment, the fact that Japan does not have any food production at home, for example.

Every country consumes a lot of manufactured goods. What share of it is imported? In the United States and every European country, the number is about 15 percent. In Japan, it is about 5 percent.

Take another indicator: The share of foreign firms in output and sales in a country. That is a measure of how open it is to foreign penetration, including investment, which Clyde was worried about. The number, in practically every European country, is 20 percent or more. In the United States, it is 10 and rising. In Japan, it is 1 percent, and it has not changed for 20 years. This is a big mistake for Japan. They do not have any American firms inside their borders to help them to lobby Congress when you get ready to hit Japan.

It is a huge mistake for them, and it is one reason we get into much tougher trade battles with Japan than with Europe. When we start to stir the pot with Europe, we have thousands of American firms coming in and saying, "Wait a minute. We have a big stake there. Don't foul it up." That is not true in Japan.

There is no doubt that Japan is an outlier in terms of its openness to foreign investment, even more so than in trade, although the numbers I indicate suggest that it is true for trade as well.

Mr. SHAYS. Just one last question to both of you. I took some actual comfort in the fact that the White House was putting more pressure on the Japanese Government because I do not see Japan ever responding without pressure. I am just wondering if you agree with Senator Bradley's criticism of the President or disagree? Senator Bradley feels that President Clinton is putting the stakes too high and playing a brinkmanship that is a dangerous game.

Mr. BERGSTEN. I have great respect for Senator Bradley and normally think very well of what he says in this area. Frankly, I thought his comments, as quoted in the New York Times this morning, were not very precise and not very well articulated.

I think we have to be careful not to shoot ourselves in the foot by the way we respond in the current trade conflict and not to produce counterproductive reactions in Japan itself. So we have to be fairly careful with how we calibrate. We have to choose a fairly sophisticated range of tools, some of which I mentioned in my earlier remarks.

But your point is absolutely correct. Without a significant amount of external pressure, there will not be any movement. Repeatedly, Japanese politicians themselves have told us that. The former Prime Minister said it publicly to us. Every study of the topic has shown it.

Threats of retaliation are always better than actual retaliation, but you have to go through with it on occasion to make it credible and get the results. I think that carefully calibrated, as the administration seems to be doing, it is a necessary part of the effort.

Mr. SHAYS. Mr. Prestowitz.

Mr. PRESTOWITZ. Like Fred, I have great respect for Senator Bradley. When he talks on issues of taxation and third world debt, I think that his remarks are usually knowledgeable and worth listening to. With all due respect, he does not know anything about Japan. He is not an expert on trade. He has never been in business. He has never bought or sold anything. I think that in this case, he is just not responding to the real world in which we live.

Mr. SHAYS. Thank you, Mr. Chairman.

Mr. SPRATT. Mr. Horn, do you have further questions?

Mr. HORN. Yes. I would like to ask one question of this panel, which I am also going to ask of the next panel.

I am told that when Toyota wanted to come to the United States, it took about two decades and a couple of oil crises before it became a major factor in the American market. The U.S. auto makers have declined to build the right-hand drive vehicles, and we now hear they might build them. That would give them ready access, if they could ever get into Japan, in terms of what the consumers are used to driving.

One of the reasons, apparently, they did not prepare these right-hand vehicles for the Japanese market is that they insisted they could not do so unless they had a guaranteed market share. In other words, they have not focused on the market in which they wish to compete. Eighty percent of the Japanese cars, I am told, have engines smaller than 2,000 cubic centimeters; there is no American car that has an engine that small, I am told.

Already, in essence, the American automakers foreclosed 80 percent of the Japanese market, just conceded it because they do not build cars that apparently 80 percent of that market have, even before you consider the fact that they did not make the right-hand drive vehicles which I mentioned earlier. What is your reaction to that comment? Is there truth to that?

Mr. PRESTOWITZ. I think it is a caricature. First of all, ask yourself the question, are there other countries in the world that drive on the right-hand side of the road? There are—Australia and the United Kingdom. The biggest manufacturer of autos in the United Kingdom is Ford. General Motors is the second largest manufacturer in the United Kingdom. Both Ford and General Motors do make cars with right-hand drive and have done so for at least 60 years or longer.

Then you ask yourself the question, if they do make right-hand drive cars, why did they not sell them in Japan? The answer is that they were never really permitted to sell them in Japan. Ford and General Motors had 90 percent of the Japanese market in 1936, when Japan passed its extraordinary bill on the automobile industry. That bill closed down Ford and General Motors operations in Japan in 1936. In 1952, Ford went back to Japan. They had an assembly plant near Yokohama. They requested permission to reopen their assembly plant in Yokohama and essentially were told to forget about it.

The reason the Japanese cars have low cc engines is because for years there was a huge tax on any car with a larger engine. That tax effectively discriminated against cars made in the United States, where we typically had much bigger cars. Again, ask your-

self the question, are there other countries in the world where small engine cars are prolific, and of course there are: The United Kingdom, Italy, Germany, and France. None of them were able to get into the Japanese market.

In fact, you read today that the Italians have a 3,000 car limit on imports from Japan. That sounds very unfair, but the origin of that limit is that back in the 1950's, the Japanese were scared to death that the Italians, that Fiat, would run over their market. So they made a deal with the Italians, and they limited the Italians to 3,000 cars into the Japanese market. The Italians, being good negotiators, said, "Fine. We will make it reciprocal," at the time not dreaming that it would be useful to them. Of course, later on, it came in very handy for Fiat.

It is also the case and we all know, as Mr. Shays said, the U.S. auto industry went through some very tough times. The quality, the productivity, the cost of building cars in the United States all got out of hand. I agree with Mr. Shays. I think the Japanese competition in many respects has been very healthy. It has resulted in a better quality, higher productivity, and lower cost in the United States. This is not in any way to say that the U.S. auto companies did not make mistakes; they did.

With regard to this question of getting into the Japanese market, this is a total red herring argument. The Koreans are only 90 miles across the straits from Japan. Nobody ever accused the Koreans of not working hard. Nobody ever accused them of not trying hard or of being bad exporters. Do you know how many cars they sold in Japan last year? Zero.

The key factor in this whole thing is the following. To sell cars, you have to have dealers. In the United States, if you are a car dealer and Nissan comes to you and says, "Please sell my Nissans," you may want to do that. You may be selling Fords or Chevrolets or Chryslers, and Ford, Chevrolet, or Chrysler may not be happy that you might want to take on a Nissan line, but they cannot do anything about it. If they muscle you, you take them to court, get an injunction, sue them, throw them in jail, collect triple damages, you are rich, and they are in jail.

In Japan, if a dealer looks crosseyed at a foreign auto salesman, he winds up in Tokyo Bay with rocks around his feet. Dealers in Japan do not carry foreign cars except with the permission of the manufacturer.

You will notice in a couple of announcements of the last month or so Nissan made the announcement that some of its dealers would start carrying Ford cars. That was greeted as a great victory by some in the United States, and the Japanese press played it up as an opening of the Japanese market. I thought it was really strange: Nissan was announcing that its dealers were going to carry Fords. Why were not the dealers announcing that they were going to carry Fords. This is the issue.

Mr. SPRATT. Could I intercede here with a question that follows that up?

Mr. HORN. Yes.

Mr. SPRATT. There have been recommendations made by both of you, I think, and Bill Bradley mentioned it in this morning's paper, that one object, and you said it was a morally high ground object,

is to go after sectoral practices, such as distribution networks that involve concerted refusals to deal, using antitrust law. How do we use domestic, U.S. antitrust law to break down internal trade relationships and dealerships in Tokyo, in Osaka, and Japan generally?

Mr. BERGSTEN. The usual concern is that some of those preferential supplier relationships have been imported to the United States right along with the transplants. One reason the local content here is low is because the Japanese producers have continued some of those relationships. Our antitrust law clearly would target that.

In addition, and I have discussed this with the antitrust authorities, there are several legal doctrines under which, if an action in Japan has a demonstrable effect on our economy, we could reach it. I think this is a feasible approach.

Mr. SPRATT. You mean, if there was a collusive trade practice, if there was some sort of concerted refusal to deal, or a preferential dealer relationship in Japan that had an impact on our economy—not on transplants doing business here but our economy—we could reach them with our antitrust law?

Mr. BERGSTEN. That is right. In addition, we would be in an even stronger position if some of those same practices were occurring within our borders, as between the Japanese transplants of auto assemblers and the Japanese transplants here of auto parts companies, which is also a big part of the equation. That, of course, is easier; that is within our borders. In addition, I think it is possible to reach back into Japan itself, with a showing of demonstrable effect on us.

Could I say one thing to Mr. Horn about the auto problem? I basically agree with the picture that Clyde Prestowitz painted, but there is one puzzle. That is, why the European car producers have done as well as they have in Japan. I am looking at the data for 1991, so they are not right up to date, but German producers in Germany sold almost 10 times as many cars in Japan as the United States Big Three did. British cars exported from the United Kingdom into Japan were about the same number as all exports from the Big Three, and there was almost as much from Sweden and France.

Korea is very low; I once asked the Japanese about that. Their answer was, they are very concerned with quality. But then there are a roughly equal number of French, Swedish, British cars, and a lot more German cars.

Another interesting statistic is that the share of European exports in U.S. auto demand is about the same as the share of European car exports in Japanese total auto demand. If we use this kind of benchmark as to what is the ratio in the other country, as the United States is doing in cases, such as Motorola, fiber optics, and others, and apply it to autos, it raises a question as to what is the anomaly. The anomaly does seem to be the very low share sold by America's Big Three into Japan vis-a-vis what we sell into Europe or elsewhere through our transplants there.

Then the question is, what is the causality? Is it a lack of effort? Is it the barrier? It is obviously a vicious circle: The firms do not try harder because they do not believe they have access. On the other hand, some of the other foreign producers coming from Eu-

rope have been able to penetrate, at least to some extent, and that I think at least has to be answered when one addresses the question.

Mr. HORN. Let me make one last comment, and I would like your view on where I am leading on this. Mr. Shays mentioned his Taurus. I have the big brother of the Taurus, which is a Mercury Sable. It is a Taurus, but you pay a little more for it, Chris. I got that because I was impressed by certain quality things in it, such as the digital dash and all the rest.

As I remember, what turned the Ford Motor Co. around is when Peterson came in, who had been in charge of the international division, and indeed has beaten the Japanese at their own game in a number of foreign countries, in Latin America and so forth, in terms of quality, a car that people wanted, and all this. When that international team came back to Ford, it is my impression that they finally got them moving.

As you know, thousands of times, the story of Mr. Deming being listened to in Tokyo but not listened to in Detroit has been told. The Japanese built in from the beginning quality control. Presumably, Detroit did not. I think the purchases of Japanese cars on the west coast would show what the consumer wanted, but now you see the shift back to American cars when they finally get the message through after 25 years in the Detroit mentality.

Part of the reason they could get that message through, that competition is good, we can do as well as they, we can have quality cars, my impression is, that was when the international crowd went back and took over Ford. What is your feeling on that?

Mr. BERGSTEN. I think that had a lot to do with it. The auto executives themselves are very clear in saying that autos now are a global market. You have to be ready to compete in all markets. That is in fact the reason for the enhanced interest they have in getting access to Japan or other foreign markets where they have been kept out. But I think that is right.

Supporting that is that General Motors has gone the same way. Their new top management team was brought in from the European operations and has that experience. Chrysler, as well. So you have an internationalization of the thinking of management and that is a big factor, I think.

Mr. PRESTOWITZ. I would agree with that.

I just wanted to make one comment on the question Fred raised about the relative success of the European producers in Japan. I think that on the one hand, it probably is true that the Europeans have been more export oriented than the U.S. producers and probably have made more of an effort in some of the export markets like Japan.

At the same time, I, too, was struck by this anomaly and dug into it awhile back. I noted that there was a very large increase in sales of Jaguars in Japan in the late 1980's and early 1990's. The Jaguar is a wonderful car, and I have always been in love with it, but no one ever accused it of being a high-quality car. Yet, it was selling like hot cakes in Japan.

You had another phenomenon which was interesting, too. While the Japanese were severely critical of the Big Three for not making cars with a steering wheel on the right-hand side, all of the Mer-

cedes Benz and BMW's that were being sold in Tokyo were being sold with the steering wheel on the wrong side.

What you were, to some extent, seeing was a phenomenon of the bubble economy. A Mercedes, a BMW, and a Jaguar are prestige items. The Japanese had lots of money in their pockets. They were buying Rockefeller Center, they were buying movie studios, and they were buying expensive cars. I think that, to some extent, accounts for the success of some of the Europeans.

I would like to make just one last comment to Mr. Horn, if I could. You raised this question of Alaskan oil, and it has been a favorite bugaboo of mine for a long time. Fred made one point, which I thought was quite right. That is, if we export the Alaskan oil to Japan, we are going to have to import it from some place else. So the overall impact on the United States, in terms of creating jobs, is neutral.

Beyond that, the truth is, the Japanese can import all of the Alaskan oil that they want. It is only that they have to take it in refined form. We have no ban on the export of refined oil products. The reason that they do not import refined oil products from us is because they themselves want to do the refining. They want to add the value. This is another example of the phenomenon of the Japanese attempting to import the raw materials and doing all the value added in Japan.

Mr. HORN. I think, Mr. Chairman, instead of economists here, we sometimes need to have sociologists to look at the cultural patterns that might be affecting decisionmaking on both sides of the Pacific.

Mr. SPRATT. Let me, for the record, Mr. Prestowitz, ask you a couple of questions just to get your views down. First of all, we had an exchange with Dr. Bergsten earlier about the utility of having quantitative measures, as opposed to just having process-oriented negotiations. How do you feel about quantitative measures as a yardstick by which to judge whether performance is being attained?

Mr. PRESTOWITZ. I am a great supporter of having some kind of a concrete measurement, and I will tell you why. I had the experience in the early and mid-1980's of engaging in endless negotiations with the Japanese over procedures.

What people today tend to forget is that when we negotiated with the Japanese over things like asking them to increase the transparency of their system, or to reduce their administrative guidance, or to change their legal procedures, whenever we did that, the Japanese would accuse us of attacking their culture. They would accuse us of being Japan bashers. It was not just a casual remark. A lot of money was spent by various institutions to present the picture of American negotiators as Japan bashers, attacking the culture of Japan because we were asking them to change some of these procedures.

We would go to the Japanese and we would say to them, "Please open your markets." We had a certain idea of what we mean by "open." The word open has a very broad connotation in the United States. We like open personalities, open procedures, open markets. It is a good word in the United States. It implies not just an open market, but it implies an open system, a transparent system.

The Japanese have a word for open. You can say "open the book" or "open your mouth" in Japanese, but the connotation of open in

Japan is not what it is in the United States. Open in Japan means an absence of formal barriers. It means no tariffs and perhaps no quotas, but it does not mean no cartels, it does not mean no controlled distribution systems.

I concluded that as long as we were talking to the Japanese about openness or fairness or other philosophical concepts, the interpretation of those concepts is so different in both countries that, although the negotiators in both countries used the same language, they just do not mean the same thing. Any agreement they reach on that is likely to be unsatisfactory because you are not going to interpret it the way they do.

Moreover, in my experience in negotiating with the Japanese—take the famous semiconductor agreement—at some point in every negotiation, the Japanese negotiators would come to you and say, "What do you really want? How much?" In the semiconductor negotiations, they would come to us and say, "How about 11-percent market share?" Our negotiators would say, "No, no. That is managed trade. We cannot talk about that." "OK, but how about 12 percent?"

My conclusion, frankly, is that you can negotiate a deal with Japan, you can negotiate over the number of distributors, market share, amount of sales, and anything concrete that you can measure you can strike a deal on, and the deal will be kept. But unless there is some concrete measurement, I fear that you are constantly going to be in this situation where you think you have something, and they think it is something else. You begin to distrust them, they begin to distrust you, and the whole relationship falls apart.

Mr. SPRATT. So you think quantitative measures sort of raise it to a different plane?

Mr. PRESTOWITZ. Some kind of objective criteria, I believe, are essential. Yes.

Mr. SPRATT. You say, on the other hand, and you have recently written a letter to the Wall Street Journal—I have a copy of it right here, February 1—indicating that you did not think Super 301 was necessarily a good idea.

Mr. PRESTOWITZ. My concern about Super 301 or 301 is that it compels the United States to convict and accuse our trading partners of being unfair. In effect, we go to them and we say, "You are a crook and a cheat. Now, let's negotiate to make you an honest man." Even if they want to negotiate, it is very hard for them to negotiate when we are publicly calling them crooks and cheats. It really complicates the whole negotiating procedure.

I think much more preferable than these formal value-laden kinds of activities are administrative and regulatory steps that the U.S. Government can take to assure essentially equal competitive conditions.

For example, we extend self-certification to Japanese auto producers. That means, when a car comes in from Japan to Long Beach, and it goes through Customs clearance, the Customs inspector could inspect that car to be sure that it complied with EPA and American safety regulations. He does not. The Japanese present him a certificate, and they say, "We assure you, this car meets your regs." The Customs inspector says, "Great. Bring it in." When an

American car goes to Japan, that does not happen. They do not give us self-certification.

We could begin to treat them in ways more equivalent to the way they treat us. I think that as that happens, rather than us going to Japan asking for negotiations, I think you would find them coming here asking us to negotiate. I think that is a much better position to be in.

Mr. SPRATT. Thank you very much for your time and for coming to testify. Mr. Horn, do you have any further questions?

Mr. HORN. Well, since Long Beach was mentioned, let me ask this. Prime Minister Hosokawa has advocated deregulation, less bureaucratic control. If that effort succeeds, will it help reduce the trade deficit? You cited a good example of where there ought to be reciprocity.

Mr. PRESTOWITZ. It depends on what you mean by success. I tell you honestly, while I very much like Prime Minister Hosokawa, and I wish him all the success in the world, and I am really pulling for him, he appointed a commission headed by a prominent Japanese businessman to develop recommendations for deregulation in the Japanese economy. When they were finally presented, they were so marginal that the leading Japanese press itself asked the question, why did the mountain labor and bring forth a mouse?

He faces a tremendous obstacle. The Japanese bureaucracy is very powerful. Ironically, it is in some ways more powerful under Hosokawa than it was under the LDP, because as a result of the fact that his coalition is a coalition of new people who have not been staffed up to deal with the bureaucracy, the power of the bureaucracy has actually expanded.

I think that it is going to be very difficult and it is going to take some time before you get thorough reform in Japan. I could imagine a situation in which you get significant reform in Japan but in which you may not see much change in Japan's trade patterns.

For example, you might reform the customs procedures or the certification procedures, but can you imagine, let us say, that the Mitsubishi group would be broken up? Can you imagine the application of American-style antitrust in Japan? Yet, if you do not get some break between the power of the interlocking companies and their ability to control distribution, it is going to remain very difficult to get into the Japanese market.

If you say thorough reform, if it were really successful, yes, I believe it would have a significant impact on Japan's trade patterns. But the question is, what do you mean by thorough reform? I think that is the big unknown.

Mr. BERGSTEN. I would be modestly more optimistic. I think, right now, Clyde is right, that the new government, the new coalition, and the new parties do not effectively control the government in Japan. The bureaucrats do have more power, and they do basically resist change. But I do think there is the possibility, over a period of several years, that the political revolution now occurring in Japan can move in the direction of real deregulation.

I will go back to something I mentioned before. When the United States was trying to get deregulation in Japan as part of the Structural Impediments Initiative talks a few years ago, all the polls showed that the Japanese public was strongly supporting the

American effort. It was a very unusual outcome in Japan. It was because we were on the side of the basic population there.

There is a fundamental problem underlying Japanese society. Their leading economic daily characterized it in an editorial a couple of years ago. The headline said, "Rich Country, Poor People."

Japan has enormous wealth. At current market exchange rates, Japan's per capita income is $30,000; ours is $20,000. It is 50 percent higher than ours, in statistical terms. But anybody who has looked at the actual standards of living in the two countries concludes the average American has a standard of living still superior by one-third or more. In other words, there is a tremendous gap between Japan's national wealth and the standard of living of the Japanese citizenry.

I do not have to tell politicians like yourselves what an enormous appeal this fact has to people who are trying to form new parties, develop new majorities, and become the governing parties of the future in Japan. The opportunities are massive to improve the prospects of the individual Japanese and, thereby, maybe secure his allegiance and his votes and set these new parties up to run the country for the next 30 or 40 years, like a different party did for the last 40.

I simply think the underlying desires—and this goes to sociology and psychology; that is probably the expertise you do need here. I would infer and hypothesize that the average Japanese citizen would also like to have better housing, shorter commuting, cheaper food, more leisure, et cetera. The politician who offers him that is going to have a very good chance to establish himself in Japanese politics for a very long time.

It is clear that the wherewithal is there to do it. It is not as if it is a resource-short country, like so many developing countries clamoring for better living standards. Japan is in the opposite situation. They have the wherewithal, but they do not use it to benefit the people. Most countries overspend and do not have the resources to support what they are trying to do. Japan is the paradox in the world on this count.

The old political system has been broken up. At a minimum, it is going to take a number of years for new parties to form and new leaders to develop. Who knows how that is going to turn out? But it does seem to me that there is a real potential for meaningful deregulation and liberalization of that economy over the coming years, based on the gut politics as I would see it.

It, therefore, seems to me important for U.S. policy to try to push that. We obviously want to pursue our immediate objectives in the way we have discussed. As a long-run proposition, if Clyde is right, that you really have to get at the heart of the thing and overcome the layers of the onion phenomenon that we have seen for the last 30 or 40 years, you want to be pushing in that direction.

That is why I think the moral battle within Japan is important, that the United States be seen on the side of unmanaging rather than managing trade, and promoting things the population wants, as it was seen to do a couple of years ago in the S.I.I. I think what we are attempting is in fact aimed in that direction, but the administration has been so unskillful in putting its case forward, it has undermined it. I think there is time to recoup, and in a sense, the

United States and Hosokawa ought to be allies against Japan's own bureaucrats and against those who resist change.

It was fascinating when the President and Prime Minister walked out to start that famous press conference 2 weeks ago. The first thing the President said, you may remember, was, "Prime Minister Hosokawa and I were both elected to effect change in our countries, but there is a lot of domestic resistance to overcome." That is absolutely right, much more so in Japan than even here.

We need to ally with him and his successors—there will be many of them and different parties and coalitions—and try to push that fundamental change. In a sense, that is the ultimate answer to what we are trying to achieve. We have to level the playing field, and then we will have a much better shot at all these problems.

Mr. HORN. You are absolutely right. I think Japan's people are in the same situation our people were in the 1890's. The change was made in the dominant party then, with Teddy Roosevelt and William Howard Taft being the trustbusters, and then carried through in another party when Wilson and Franklin Roosevelt came in. That is exactly what the Japanese consumer needs.

Mr. SPRATT. We could go on because you have been enormously useful. We would go on but for the fact that we have a panel behind you on deck. I know you are not government-paid witnesses, working in Treasury and Commerce any more, but we will not hesitate to send you some questions, if we might, to get your further viewpoints and get some clarifications and elaborations for the record. Thank you so much for coming, for your very useful testimony, and your excellent responses to our questions.

Our second panel also includes some very distinguished witnesses who represent key American industries. First, we welcome Mr. Andrew Card, who is the former Secretary of Transportation under President Bush. Mr. Card is now president and chief executive officer of the American Automobile Manufacturers Association.

Second, we welcome Mr. Wolff, Former Deputy U.S. Trade Representative in the Carter administration. Mr. Wolff is general counsel to the Semiconductor Industry of America. Mr. Wolff has extensive experience negotiating with Japan.

Last, but not least is Mr. David Gridley, a good friend and director of sales and governmental affairs for the Torrington Co. Torrington was one of the two largest ballbearing manufacturers in the United States. Mr. Gridley will provide a perspective from the American autoparts industry.

Mr. Card came despite the fact that he has another engagement. In deference to his schedule, we will go with him before turning to Mr. Wolff and Mr. Gridley. Mr. Card, thank you very much for coming. We have your testimony and will make it part of the record. We look forward to hearing from you. The floor is yours.

## STATEMENT OF ANDREW H. CARD, JR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, AMERICAN AUTOMOBILE MANUFACTURERS ASSOCIATION [AAMA]

Mr. CARD. Thank you very much, Mr. Chairman. My name is Andrew H. Card, Jr., and I am president and chief executive officer of the American Automobile Manufacturers Association. AAMA is the trade association of America's car companies; that is, Chrysler

Corp., Ford Motor Co., and General Motors Corp. Our companies directly employ some 730,000 men and women in the United States, and we account for 19 of 20 U.S. jobs engaged in building automobiles. Together with our dealers and suppliers, our industry employs some 2.3 million Americans.

Mr. Chairman, I appreciate the chance to share some thoughts with you and your committee, and I want to thank you for this opportunity. I think this is the first opportunity for witnesses to present views on the recent breakdown of the Japan framework negotiations with the United States, and I am honored to be among your first witnesses.

Let me state clearly that America's car companies applaud the Clinton administration's courage to hold firm in the framework negotiations and to refuse to paper over our serious trade problems with Japan. Despite the intense pressures and competing geopolitical interests in the bilateral relationship, we agree with the administration's firm stand for a results-based agreement. This kind of agreement is the only way the United States can make clear that trade relations must be rebalanced and that the Japanese domestic market must be opened.

Last year, President Clinton and Prime Minister Miyazawa called for "qualitative and quantitative measures" to be included in the framework negotiations as a means to measure progress. Despite the breakdown in talks, that agreement still remains today.

In 1993, the trade imbalance in autos and parts alone accounted for close to 60 percent of the entire United States trade deficit with Japan. Significantly, in agreeing to establish a separate negotiation on the automotive trade imbalance in the framework, even the Japanese Government recognized that no major reductions in the imbalance could be possible without giving high priority to the automotive trade part of the equation.

Further, both governments agreed to seek an expedited solution in the automotive sector, prior to the planned February 11, 1994, summit meeting between President Clinton and Prime Minister Hosokawa. Six months of intensive negotiations, however, failed to produce a meaningful agreement to open Japan's closed auto and auto parts market.

The United States correctly terminated its participation in the framework process, saying that no agreement was preferable to a weak and meaningless one. Indeed, rather than a constructive response, Japan unleashed a major political and public relations offensive to undermine the administration's framework objectives.

As a committed free trader, I personally reject the notion that the Clinton administration's call for measurable results in improved market access is "managed trade." In reality, the most glaring example of successful managed trade in the world today in the Japanese automotive market itself, where imports from all countries—European, Asian, and North American—total only 3 percent of the market.

American car companies currently sell about the same number of cars in Japan as Toyota and Nissan alone sell in the State of South Carolina. Proponents of more open trade should strongly support our government's effort to open this utterly closed market and com-

mend our negotiators for keeping the talks focused on expanding trade, not restricting it.

In recent years, the American auto industry has staged perhaps the most dramatic turnaround of any major manufacturing industry in our history. I am proud to say that the industry did it the old-fashioned way: We met our competition head on, listened to our consumers, and regained the cutting edge in innovation and quality.

American consumers have responded to our products' quality, value, and innovative styling just as we hoped they would. In 1993, America's automakers' sales in the United States increased 10 percent over 1992, and we won significant market share back from our import competitors. Even foreign car makers who assemble cars here are now proudly advertising their American heritage.

However, our success in the world's largest and most brutally competitive car market, the United States, and in the other major markets around the globe is not duplicated in the world's second largest car market, Japan. While Japanese car makers have had virtually unrestricted access to the United States market, Japan's market is all but closed to our products.

Because of our long experience with restricted access in Japan, AAMA supported the fundamental market access goals for the automotive sector as originally presented by the U.S. negotiators in the framework talks. The objectives were:

First, reduction in Japan's trade surplus; second, increased sales of American vehicles in Japan; third, increased sales of American parts in Japan; and fourth, increased sales of American parts to transplants located in the United States.

American car makers believe that if the framework negotiations had resulted in serious and meaningful market-opening measures in Japan, their sales in the Japanese market could increase from levels of less than 20,000 units in 1993 to approximately 120,000 units within 3 years.

Let me emphasize that neither we nor our government ever suggested that Japanese consumers somehow be pressured or forced to buy American products. That was a giant red herring argument, endlessly repeated by Japanese Government representatives and fanned by the Japanese media, to belittle the administration's serious negotiating efforts by misleading academics and trade policy observers and frightening Japanese consumers.

After years of fruitless talks between the two governments, trading charges and counter-charges about the problems in Japan's auto market, 2 years ago, the Government of the United States and Japan together commissioned an official study of the Japanese vehicle market. It is the MOSS report. The MOSS Motor Vehicle Study, released this month, concludes what our companies, as well as Europeans, have been saying all along; that many factors prevent Japanese consumers from having ready and open access to imported vehicles.

The three "smoking gun" facts of the MOSS study are: First, that the Japanese automotive dealer distribution system has locked out foreign companies from the Japanese market.

Second, the barriers to the Japanese market forced Japanese consumers to pay as much as 40 percent more for the imported vehi-

cles than they would if the barriers had been removed. In fact, if costs are calculated at current exchange rates, the market barriers push up the cost of an imported car by over 50 percent. To a consumer, that looks just like a tariff.

Third, Japanese consumer demand for imported vehicles is substantially higher than Japanese Government and industry officials have previously indicated.

The MOSS report is something I hope you will review, and I would encourage you to put the MOSS report executive summary in your official record of this hearing.

There is no question that American automakers are interested in and committed to selling in the Japanese market. The globally competitive economics of the auto industry and the importance of the Asia-Pacific region as a future growth market alone require these commitments.

The announcement by President Clinton and Prime Minister Hosokawa of the breakdown in negotiations has led to the collapse of the framework and any hopes of real action in correcting the trade imbalance. More than any other development, the recent strengthening of the yen has confirmed the deliberate risks that Japan has taken in ignoring both the seriousness of the trade imbalance and the determination of this administration to open the closed markets to imported products.

AAMA firmly believes that the correctness of the U.S. position in the framework negotiations was not diminished by Japan's failure to accept it. We want to see an open market. The framework was and is about opening Japan's market. That is the goal. Indeed, given the collapse of the framework negotiations, we urge the administration to continue to support a strong yen and to consider all tools at its disposal to reinforce its stated policy that Japan's trade imbalance with the United States and the world is just not sustainable.

In the post-cold war era, in which national influence is increasingly defined by economic rather than military strength, how the United States responds to this impasse with Japan has policy implications that extend far beyond our two countries alone. Many developing nations are trying to recreate the Japanese model by building economies based excessively on exports, while rigidly protecting their home markets from competition.

South Korea, for example, has the fastest-growing domestic automobile market in the world and is also building an enormous auto manufacturing capacity geared to an aggressive export strategy. If American products and American workers are to have a chance to compete for a share of growing markets around the world, our government must be both forceful and consistent in negotiating market-opening agreements.

Prime Minister Hosokawa has pledged to deliver change for the Japanese people, including a new relationship with the United States and the world that increases market access of competitive foreign goods. The surest way to ensure a new relationship is through an action plan that produces open markets. That applies in Japan as well as other nations around the world.

What the United States sought through the framework negotiations was for the Japanese Government to commit to the same free

market access in its home market that it tenaciously seeks in the United States, Europe, and other major markets. The Japanese claim they are for free trade, but they do not practice it at home. Japan's Government is a strong believer in free trade in every market but its own, and we must continue to stand firm in our efforts to bring the fruits of free trade to the Japanese consumer.

While I was in Tokyo, I had the pleasure of addressing a group of students at Keio University, who had read about our cars but had never had the opportunity to experience them. They cannot find them in showrooms. I asked them, "Who should determine what car consumers should buy?" One student answered, "Okyaku-sama wa kamisama desu." The translation: "The consumer is supreme." I could not have said it better. Let us compete by gaining access to their consumers. Let the consumers decide if they like our products. We think they will. Thank you, Mr. Chairman.

[The prepared statement of Mr. Card follows:]

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Andrew H. Card, Jr
President and Chief Executive Officer

Testimony of

ANDREW H. CARD, Jr.

President and Chief Executive Officer

AMERICAN AUTOMOBILE MANUFACTURERS ASSOCIATION

before the

House Committee on Government Operations

February 24, 1994

## AMERICAN AUTOMOBILE MANUFACTURERS ASSOCIATION

**Testimony before the**

**House Committee on Government Operations**

**February 24, 1994**

My name is Andrew H. Card, Jr., President and CEO of the American Automobile Manufacturers Association. AAMA is the trade association of America's Car Companies, Chrysler Corporation, Ford Motor Company, and General Motors Corporation. Our companies employ more than 730,000 American men and women, accounting for 19 of 20 U.S. jobs engaged in building automobiles. Together with our dealers and suppliers, our industry employs 2.3 million Americans.

Chairman Spratt and members of the Committee, I want to thank you for the opportunity to testify here today. Your subcommittee, I believe, is the first Congressional panel to examine the recent breakdown of the U.S.-Japan Framework negotiations and I am honored to be among the first witnesses called to discuss these developments before the Congress.

Let me state clearly that America's Car Companies applaud the Clinton Administration's courage to hold firm in the Framework negotiations and refuse to paper over our serious trade problems with Japan. Despite the intense pressures and competing geopolitical interests in the bilateral relationship, we agree with the Administration's firm stand for a results-based agreement. This kind of agreement is the only way the U.S. can make clear that our trade relations must be rebalanced and the Japanese market opened.

In 1993, the trade imbalance in autos and parts alone accounted for close to 60 percent of the entire U.S. trade deficit with Japan. Significantly, in agreeing to establish a separate negotiation on the automotive trade imbalance within the Framework, even the Japanese government recognized that no major reductions in the imbalance could possibly be achieved without giving a high priority to automotive trade. Further, both governments agreed to seek an expedited solution in the automotive sector prior to the planned February 11, 1994 summit meeting between President Clinton and Prime Minister Hosokowa. Six months of intensive negotiations, however, failed to produce a meaningful agreement to open Japan's closed auto and auto parts market, and the United States correctly terminated its participation in the Framework process, saying that no agreement was preferable to a weak and meaningless one.

The President made it clear from the beginning of this initiative that the chronic trade imbalance between the U.S. and Japan was unacceptable and must be reduced rapidly and dramatically. The response from Japan over the six months of negotiations generally consisted of a refusal to acknowledge the need for any change in the trade imbalance between the two countries. Indeed, rather than a constructive response, Japan unleashed a major political, and public relations offensive to undermine the Administration's Framework objectives.

**The U.S. Auto Industry's Objectives in the Framework Negotiations**

As a committed free trader, I personally reject the notion that the Clinton Administration's call for measurable results in improved market access is "managed trade." In reality, the most glaring example of successfully managed trade in the world today is the Japanese automotive market itself, where imports from all countries -- Europe, Asia, and North America -- total only three percent of the market. American car makers currently sell about the same number of cars in Japan as Toyota and Nissan alone sell in the state of South Carolina. Proponents of more open trade should strongly support our government's efforts to open this utterly closed market and commend our negotiators for keeping the talks focused on expanding trade, not restricting it.

Every administration since President Nixon has recognized that a sustained and growing trade imbalance between the U.S. and Japan is unhealthy for both nations. But after twenty years of discussions, hundreds of studies of the problem, major exchange rate adjustments, and endless negotiations, U.S. trade with Japan remains extraordinarily and chronically imbalanced.

One factor that has changed, however, is the competitiveness of the American auto industry. In recent years, the American auto industry has staged perhaps the most dramatic turnaround of any major manufacturing industry in our history. I am proud to say that the industry did it the old-fashioned way: We met our competition head on, listened to our customers, and regained the cutting edge in innovation and quality.

American consumers have responded to our products' quality, value, and innovative styling just as we hoped they would: In 1993, American auto makers' sales in the U.S. increased 10 percent over 1992, and we won significant market share back from our import competitors. Even foreign car makers who assemble cars here now proudly advertise their "American" heritage.

However, our success in the world's largest and most brutally competitive car market -- the U.S. -- and in the other major markets around the globe is not duplicated in the world's second-largest car market, Japan. While Japanese car makers have had virtually unrestricted access to the U.S. market, Japan's market is all but closed to our products.

Like consumers all over the world, Japanese consumers seek the best value and the highest quality in purchasing cars and trucks and America's carmakers have made great strides in both areas.

Because of our years of experience being denied access to Japan's market, AAMA supported the negotiating position as originally presented by U.S. trade officials in the Framework talks. The objectives outlined in that position were:

1) a reduction in Japan's trade surplus;

2) increased sales of American vehicles in Japan;

3) increased sales of American parts in Japan; and

4) increased sales of American parts to transplants located in the U.S.

American car makers believe that if the Framework negotiations had resulted in serious and meaningful market opening measures in Japan, their sales in Japan could increase from levels of less than 20,000 units in 1993 to approximately 120,000 within three years. The real question is why the Japanese are absolutely stonewalling such a modest goal. We are not asking for guaranteed sales but equal opportunity. We believe our products will sell themselves given such an opportunity.

Finally, let me emphasize that neither we, nor our government ever suggested that Japanese consumers somehow be pressured or forced to buy American products. This was a giant red herring argument endlessly repeated by Japanese government representatives and fanned by the Japanese media, to belittle the Administration's serious negotiating effort by misleading academics and trade policy observers around the world and frightening Japanese consumers. America's Car Companies simply seek the opportunity to reach Japanese consumers, in the same way Japanese manufacturers do with U.S. consumers. We want to show them what American consumers and American workers have together created -- an extraordinary range of high quality products aimed at meeting a variety of car buyers' needs.

## The Japanese Automobile Market

American and European automakers have a long history of experiencing restricted access in Japan's automobile market. Despite various reforms announced from time to time when trade tensions rose, there is now an authoritative 'smoking gun' in the form of a major new comprehensive study of the Japanese auto market commissioned by both the Japanese and U.S. governments. The study confirms that Japan's market for automobiles remains virtually closed to foreign manufacturers today.

After years of fruitless talks between the two governments trading charges and counter-charges about the problems in Japan's auto market, the governments of the U.S. and

Japan together commissioned an official study of the Japanese vehicle market. The MOSS Motor Vehicle Study, released only this month, concludes what our companies as well as the Europeans, have been saying all along: that many factors prevent Japanese consumers from having ready and open access to imported vehicles. The 'smoking gun' facts of the MOSS Study are:

**Fact #1:** The Japanese automotive dealer distribution system has locked out foreign companies from the Japanese market.

**Fact #2:** Barriers to the Japanese market force Japanese consumers to pay as much as 40 percent more for imported vehicles than they would if the barriers were removed. [In fact, if costs are calculated at current exchange rates, market barriers push up the cost of an imported car by over 50 percent.]

**Fact #3:** Japanese consumer demand for imported vehicles is substantially higher than Japanese Government and industry have previously indicated.

Dealers and Distribution

Because Japan has the highest land costs in the world, and because vacant land suitable for auto dealerships is nonexistent in Japan's population centers, foreign auto makers seeking to enter the Japanese market must rely on selling cars through existing dealer networks. However, the MOSS study finds that American car makers continue to face significant barriers to their cars being sold alongside Japanese cars in Japanese showrooms.

In the U.S., "dual dealerships," or those handling both domestic and imported models, are common. Japanese manufacturers rapidly gained market share in the U.S. during the 1970s and '80s because existing American dealers were free to market imports alongside domestic nameplates. In Japan, however, dealers were prohibited from handling imports until 1980 and, as late as four years ago, still were required to consult Japanese manufacturers before carrying import models.

The MOSS Study finds that this tradition of exclusivity endures today, even if on a less formal basis. Nearly 50 percent of surveyed dealers responded that they would not sign another franchise agreement because of their working relationship with a domestic Japanese manufacturer. The study also finds only about 18 percent of Japanese dealers handle imported cars (excluding those imported from Japanese transplants) alongside Japanese cars. Moreover, many of those dealers do little to market imports, and thus import sales account for only about three percent of total units sold by all dealerships.

Japanese government and industry officials long have maintained that Japanese dealers are free to sell any cars they wish. The reality is that, while it may be true that written

"exclusivity clauses" have been eliminated, the practice of manufacturer-dealer exclusivity is still plainly evident.

I visited Tokyo in January to bring the message of free trade to the Japanese and to see for myself how Japan's market functions. While I was in Tokyo, I took the time to visit a Toyota dealership located near the American embassy. The manager was exceedingly polite and seemed pleased for the opportunity to show me around his business. I asked him directly, "Would you sell an import? He said no, I sell Toyotas. What if your customers asked you to carry American-made cars?" His answer was a still polite, but very firm, "NO!"

That answer is precisely why our government's position in the Framework focused on gaining an overall commitment from Japan to provide market access, rather than on the narrower details. America's Car Companies only want the opportunity to enter into franchise agreements with dealerships they consider promising, without the dealers' being concerned about retribution from the Japanese manufacturers. This is precisely the way that Japanese companies entered and achieved rapid market growth in the U.S., and U.S. laws protected that right to dealer access. In a short time, Japanese companies entered into franchise agreements with thousands of Chrysler, Ford, and General Motors dealers without retribution by our companies. Such franchise agreements, by the way, typically contain sales goals, or "targets."

## The Myths of Selling Cars in Japan

When all the technical and legal discussions are over, Japanese officials repeatedly tell us that American cars just are not "right" for Japan. The arguments frequently repeated unquestioned in the Japanese press are that Americans don't offer right-hand drive (RHD) models, that our cars are too big for Japanese roads, our engines are too large, the cars cost too much, and we are not committed to marketing them. Let me dispense with these in order:

Myth #1: Right-hand Drive Vehicles. Although a major share of Japanese import car buyers choose to purchase left-hand drive cars, the three U.S. companies are now preparing to offer at least nine right-hand drive models in Japan. Chrysler is already selling an RHD version of the popular Jeep Cherokee, while GM offers RHD Opels. Meanwhile, a strong if limited market continues to exist for left-hand drive versions of other models, such as the Pontiac Grand Prix.

Myth #2: Vehicle Size. While I was visiting the dealership in Tokyo, I asked a customer if he would be interested in buying an American car. He said probably not because he had heard they were "too big for Japanese roads." Then he got in his Toyota Crown and drove away. The catch is that the Crown itself is larger than the Ford Taurus. I hope he comes back for a look

when Ford introduces the right-hand drive version of the Taurus later this year.

Myth #3: Engine Displacement. Meanwhile, we are told that cars with engines larger than 2,000 cc, which describes most American cars destined for the Japanese market, represent less than 20 percent of the Japanese market. But 20 percent of the Japanese market is still about 1.4 million vehicles and it is the fastest growing segment in Japan, and one in which the U.S. already dominates in all other major markets. Given our current 0.4 percent market share, U.S. companies would be very happy to gain a fair portion of that 20 percent. You may be certain that, if American car companies are targeting a certain segment of the market, it is because they are already the world leaders in that segment everywhere but Japan.

Myth #4: American Marketing Efforts. Making major financial decisions about marketing efforts in a systematically closed market has been a classic "chicken and egg" dilemma. MITI officials charge that Americans don't sell cars in Japan because we do not commit seriously to doing so, and we respond that it is difficult to justify major expenditures in a market you know is closed. There are too many other promising markets around the world competing for attention. Just look at changes in the whole Eastern Bloc, Asia, and Latin America. Our companies responsibly commit the shareholders' capital when there is a fair and reasonable expectation of return on that capital, future growth, and ultimate profitability.

Nonetheless, even though Japan's market remains closed today, American car makers have committed to making the substantial marketing investments needed to increase sales in that country. All three companies are putting in place the resources -- the people, plans, and marketing strategies -- that will expand sales opportunities in Japan if the market is opened.

So, there is no question that American automakers are interested and committed to selling in the Japanese market. The globally competitive economics of the auto industry and the importance of the Asia-Pacific region as a future growth market alone require these commitments. The real question is, how will Japan respond?

**After the Summit**

The announcement by President Clinton and Prime Minister Hosokawa of the breakdown in negotiations on trade in autos and three other sectors has led to the collapse of the Framework and any hopes for real action in correcting the trade imbalance.

More than any other development, the recent strengthening of the yen has confirmed the deliberate risks that Japan has taken in ignoring both the seriousness of the trade

imbalance and the determination of this Administration to open its closed market to imported products. AAMA firmly believes that the correctness of the U.S. position in the Framework has not been diminished by Japan's failure to accept it. The Framework was, and is, about opening Japan's market. Indeed, given the collapse of the Framework negotiations, we urge the Administration to continue its support for a strong yen and to consider all tools at its disposal to reinforce its stated policy that Japan's trade imbalance with the U.S. and the world is not sustainable.

In the post-Cold War era, in which national influence is increasingly defined by economic rather than military strength, how the U.S. responds to this impasse with Japan has policy implications that extend far beyond our two countries alone. Many developing nations are trying to recreate the "Japan Model" by building economies based excessively on exports while rigidly protecting their expanding home markets from competition. South Korea, for instance, has the fastest growing domestic automobile market in the world and is also building an enormous auto manufacturing capacity geared to an aggressive export strategy. If American products and American workers are to have a chance to compete for a share of growing markets around the world, our government must be both forceful and consistent in negotiating market opening agreements.

Prime Minister Hosokawa has pledged to deliver change for the Japanese people, including a new trade relationship with the U.S. and the world that increases the market access of competitive foreign goods. The surest way to ensure a new relationship is through an action plan that ensures market-opening results, which is simply another phrase for a philosophy Japanese industry and government fully understand: management by objectives. Measurable results in the market place are necessary for these talks to be more than just empty rhetoric. Setting clear market-access objectives will force the removal of long-standing barriers between the Japanese consumer and imported products.

What the United States sought through the Framework negotiations was for the Japanese government to commit to the same free market access in its home market that it tenaciously seeks in the U.S., Europe, and other major markets. Japan's government is a strong believer in free trade in every market but its own and we must continue to stand firm in our efforts to bring the fruits of free trade to the Japanese consumer.

While in Tokyo, I had the pleasure of addressing a group of students at Keio University who had read about our cars but had never had the opportunity to experience them. I asked them, "Who should determine what cars consumers can buy?"

One student answered, *"Okyaku-sama wa kamisama desu."*

Translation: "The customer is God." I couldn't have said it better.

Mr. SPRATT. Mr. Card, thank you very much. I would note for the record that even though you were born in Massachusetts, due to the lack of universities there, you came to South Carolina for your education, but we were not able to teach you how to speak correctly.

Mr. CARD. I still park the car in Harvard yard.

Mr. SPRATT. Let us now go to Mr. Alan Wolff. Mr. Wolff, let me say before you testify, and to all the witnesses, just for the record, that we have your prepared testimony. We will make it part of the record, if there is no objection, so that you can summarize parts of it if you wish.

## STATEMENT OF ALAN WILLIAM WOLFF, DEWEY BALLANTINE, WASHINGTON, DC, ON BEHALF OF THE SEMICONDUCTOR INDUSTRY ASSOCIATION

Mr. WOLFF. Thank you very much, Mr. Chairman. I appreciate the opportunity to testify this morning. I will do so wearing two hats, one in my personal capacity as a former United States trade negotiator with Japan over the last quarter of a century: The first half of that period was, in part, as U.S. Deputy Trade Representative and the second half, on behalf of the Semiconductor Industry Association, as counsel.

There is no trade policy issue of greater importance today than that of dealing effectively with Japan. Just look at this morning's newspaper with Bill Bradley's statements, and Jay Rockefeller's and Dick Gephardt's introduction of legislation. This is a key issue that has come to occupy center stage.

The issue is clear: Are America's commercial interests still to be subordinated to a variety of other interests that are claimed to be seriously and adversely affected by the pursuit of national commercial interests? I think it is as simple as that.

The latter, "other interests," include whether Mr. Hosokawa remains in power. I would point out that about 1 year or 1½ years ago, we were worried about whether Mr. Miyazawa would remain in power. We were told we could not press trade issues then. Then it was whether the LDP would fall. Now it is whether the LDP will come back. Will the pursuit of U.S. commercial interests adversely affect the friendship of the two peoples or the security relationship of the two nations. We have followed a traditional path in the past of unquestioningly sacrificing American commercial interests to foreign policy goals, and we must cease doing so.

At the same time that the foreign policy argument is being brought out, there is a steady stream of articles by economists and commentators holding that seeking an open market in Japan cannot for a variety of macroeconomic reasons really achieve substantial results, contrary to anyone's experience or intuition. Further, it is said that even to ask for results, even if it brings a liberalization of trade, will undermine the basic structure of our economic universe, and a results-oriented policy is to be condemned. As Fred Bergsten correctly said this morning, that position is completely ridiculous.

The semiconductor agreement is the first, and currently the only, agreement with Japan to insist very clearly on results. It sparked much debate, probably because it has worked, confounding its crit-

ics. The U.S. Government did not come naturally to it. It was a Republican laissez-faire administration and a particularly free trade USTR, Clayton Yeutter, who negotiated the agreement originally in 1986. The U.S. Government and industry did not come lightly to this approach. It was after 16 years of failed negotiations and plain bad faith on the part of the Japanese signatories to prior agreements.

Living with Japanese competitors that sold their goods in, and for export from, a closed home market sanctuary would have put American firms at a permanent and disastrous disadvantage. Japan was the world's largest market for semiconductors. It supplied us with VCR's and laptop computers and a host of other products, including automobiles that include a lot of semiconductors. To cede Japan its own market, which means its own market not only for end use in Japan but for exports as well, would have been tantamount to accepting the decline of the U.S. semiconductor industry.

There were some rough patches along the way toward getting the implementation of this agreement to take place. It required the imposition of the first sanctions against Japan since the 1930's. But, as a result of all of the activities, foreign companies have made inroads in Japan that would not otherwise have occurred. That goes for the Koreans and Europeans as well.

More trade has taken place on the basis of competitiveness of products, as opposed to relying on the nationality of producers, than would have taken place in the absence of the two semiconductor agreements.

Why did we succeed? First, inclusion of a quantitative objective, the 20-percent share objective, was key. It was not a guarantee, but it was an indicator, an objective indicator, of whether progress is being made. It was chosen because the Japanese could not satisfy this number with just purchases by the big, vertically integrated competitors of U.S. firms. Otherwise, they would have done so, and access would have remained limited.

We were seeking not virtual market access but real market access. We were highly competitive and we still are. We outcompete, and we outsell Japan in every world market outside of Japan by a ratio on average of 2 to 1.

Second, the U.S. semiconductor industry dedicated the efforts needed to penetrate the Japanese market, and those efforts are documented in my testimony. The two governments and industry worked extensively together. The U.S. Government never gave in. In this case it devoted the necessary resources. We enforce environmental regulations with hundreds of Federal employees. The number of Federal employees dedicated to follow up on trade agreements can be counted on the fingers of one hand.

Third, the U.S. Congress and three U.S. Presidents have enforced the agreement. We gave it a political priority. The House Ways and Means Committee, the Senate Finance Committee, the full membership of the House, the full membership of the Senate, and I hope in the future, increasingly this committee will press hard for Japanese compliance with this agreement and with the other agreements that I hope will be entered into and the ones that have been entered into with Japan.

The particular facts of semiconductors may differ from some other product areas. Semiconductors are industrial intermediates. It is true of bearings, I suspect, and it is true of auto parts as well. Our market share target made a great deal of sense for our industry. We were dealing with a small group of vertically intergrated companies that preferred to deal with each other, rather than buy on the basis of the competitiveness products offered.

We have achieved a measure of success, but I must report that in the last three consecutive quarters, there has been a fall off in foreign market share in Japan. That fall off, a 2-percentage point drop in the first three quarters of this year, represents on an annualized basis $400 million in U.S. sales that did not take place.

The agreement, however, is essential, and we hope that the Japanese will redouble their efforts. We will certainly increase our efforts to reverse the slide and resume steady progress. There must be compliance with the agreement, or there will have to be enforcement of it.

In light of what was said by the first panel, I have to report that the exchange rate has not made a major difference to us over time. There have been high yen and low yen periods; foreign firms have remained residual suppliers. Domestic stimulus in Japan has not made a major difference to us over time. Appeals to consumers alone do not make a difference.

I made speeches 15 years ago, when I was in government, about the necessity of improving the standard of living of the Japanese citizen. Do not rely upon this solving our problem soon. You ask any Japanese reporter stationed in Washington whether he will report on the house in which he lives in Bethesda or in McLean for his paper back home, and they will say that their edition will not print it. Those articles do not exist.

The United States-Japan framework builds on the approach that was used in semiconductors—the use of a quantitative indicator. It builds on the approach that took place in 1978 in an agreement negotiated by the Carter administration, having macro elements, structural elements, and sectoral elements as well.

I would caution those who are critics of the current administration's trade policy to think of the consequences of not following the current path of this administration to achieve something that more closely resembles the functioning of an unfettered market in Japan. There are only three policy options out there:

First, we can live with an inequitable trading relationship and say it does not matter; that is, that the composition of the U.S. economy does not matter. But that would deny reality and we cannot accept it.

Second, we can restrict Japanese exports to this market. The Europeans have used this as their policy, their treatment of Japan, over the years. That policy, if adopted by the United States, would be harmful to all concerned.

The third option is that we can doggedly insist upon results. And that is what President Clinton and Ambassador Cantor are currently doing. There is no other acceptable option.

I would just mention very briefly this morning's reference to today's New York Times article quoting Senator Bradley as calling for alternative means of settling disputes. It is a curious thing.

Would we say that our interests in Bosnia should be settled by a panel of one Bosnian or Serb, one American, and one fellow from Uruguay or Paraguay or any place else? No. We are going to determine what our national interest there is and pursue it.

Would we say that on North Korea's nuclear capability, we are going to have an independent panel review what U.S. policy will be and be bound by it? Absolutely not. It is absurd. We would not do it.

When will we intervene to protect the Panama Canal in the future? We would not trust the decision to a panel of three wise men.

If the President and Congress cannot agree on what a statute should be, are we going to place the issue in arbitration before a panel? No. We would not think of it for a moment.

There are tough choices to be made in life, and tough choices to be made by governments. We are a powerful country. We have interests to pursue. Some of our interests are commercial interests. We cannot delegate these to a panel of independent wise men.

Mr. Chairman, that concludes my testimony. On behalf of SIA, I want to thank the subcommittee again for the opportunity to share views with you. I will be pleased to answer any questions and submit remarks for inclusion in the record.

[The prepared statement of Mr. Wolff follows:]

STATEMENT OF

ALAN WM. WOLFF,
DEWEY BALLANTINE, WASHINGTON, D.C.

ON BEHALF OF

THE SEMICONDUCTOR INDUSTRY ASSOCIATION

BEFORE THE

COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE

OF THE

GOVERNMENT OPERATIONS COMMITTEE,

UNITED STATES HOUSE OF REPRESENTATIVES

FEBRUARY 24, 1994

The Semiconductor Industry Association (SIA) is pleased to have the opportunity to testify before this subcommittee about an issue that long has been one of SIA's top public policy priorities -- obtaining access to the Japanese market.

SIA is comprised of U.S.-based semiconductor manufacturers that account for 85 percent of U.S. semiconductor production and employ more than 240,000 Americans. SIA was created in 1977 to address the public policy issues confronting the industry.

Recently, in remarks to the Congressional Research Service, I addressed the U.S. - Japan trading relationship generally, examined the Clinton Administration's approach to correcting our trade imbalance and opening Japanese markets, and offered recommendations for improving this vital bilateral relationship. Mr. Chairman, with the subcommittee's permission, I would like to submit these remarks for the record as an attachment to my testimony.

Today, I will direct my testimony primarily to the U.S. semiconductor industry's experience in seeking access to the Japanese semiconductor market. In addition to briefly discussing the history of U.S. - Japan relations in this product sector, I will offer several reasons why the 1986 and 1991 Semiconductor Agreements -- unlike most of the more than 30 other bilateral trade agreements the U.S. has signed with Japan since 1980 -- have been relatively successful.

A Brief History of Efforts to Open Japan's Semiconductor Market

The U.S. Government has been attempting to obtain full access to the Japanese semiconductor market for U.S. semiconductor manufacturers for more than 20 years. In 1971 and 1982, and again in 1983, the U.S. Government mounted major efforts to persuade Japan to open its semiconductor market and reached agreements to this end. But foreign share remained limited to a level far below what any objective measure of U.S. competitiveness would have suggested. After the 1983 Agreement, foreign share in the Japanese market fell dramatically, despite Japan's formal agreement to liberalize imports.

In 1985, in reaction to Japan's violation of its 1983 commitments, SIA filed a petition against Japanese semiconductor producers pursuant to Section 301 of the Trade Act of 1974. At about the same time, several U.S. companies and the U.S. Commerce Department filed antidumping cases in reaction to dumped Japanese DRAMs and EPROMs -- computer memory chips. As a result of this massive Japanese dumping, six out of eight U.S. DRAM producers were driven out of business.

At the same time that these cases were pending, the United States and Japan entered into negotiations designed to reach an overall agreement on semiconductors. In 1986, the two governments signed the 1986 U.S. - Japan Semiconductor Agreement, wherein Japanese semiconductor producers agreed not to dump in any world market and the Japanese Government, in a side letter, recognized the U.S. industry's expectation that the foreign share of the Japanese semiconductor market should grow to more than 20 percent by the end of July 1991.

Despite the 1986 Agreement, Japanese dumping continued and the foreign market share remained stagnant. Consequently, President Reagan, on April 17, 1987, announced sanctions against Japanese electronics products. U.S. retaliatory action brought about a change in the Japanese attitude. The foreign share of the Japanese semiconductor market rose from 9 percent during the first quarter of 1987 to 14 percent during the first quarter of 1990.

Despite the positive effect that retaliatory measures had on opening the Japanese market, by 1990 it was evident that the target foreign market share of 20 percent would not be reached by the time the 1986 Agreement expired on July 31, 1991. Nevertheless, because the 1986 Agreement had led to increased foreign access and because the foreign share was on a trend line to achieve 20 percent by the end of 1992, SIA preferred the negotiation of a new agreement that would build on the existing momentum toward a more open Japanese market to the alternative of new sanctions.

Consequently, the United States and Japan reached a new accord -- the 1991 U.S. - Japan Semiconductor Agreement -- in which the Government of Japan formally reaffirmed its recognition of the expectation that foreign market share in Japan should reach at least 20 percent by the end of 1992. In effect, the 1991 Agreement extended the market access provisions of the 1986 Agreement for five years, but set a 17 month limit on reaching or exceeding the 20 percent objective, and called for gradual and steady progress thereafter.

As with the 1986 Agreement, however, there was no meaningful increase in foreign share in the months after the 1991 Agreement was signed. Consequently, in

April 1992, the Senate Finance Committee asked the Bush Administration to review Japan's compliance with the Agreement and, in August 1992, the U.S. Government concluded that Japanese Government and industry efforts had not been sufficient.

In the face of the Senate Finance Committee's request, Japanese user companies and U.S. semiconductor suppliers agreed to a series of emergency measures on June 4, 1992 designed to improve foreign market access. In part because of these emergency measures, foreign market share increased from about 14 percent to 20.2 percent during the fourth quarter of 1992.

During 1993, however, the foreign share has dropped steadily for three consecutive quarters and now stands at 18.1 percent. The declining foreign market share violates the terms of the 1991 Agreement, which calls not just for a 20 percent foreign market share by the end of 1992, but for "gradual and steady" progress until the Agreement expires in July 1996. The two percentage point drop in foreign share in 1993 will cost U.S. semiconductor manufacturers about $400 million in annual sales and will have significant negative effects on U.S. employment and investment in research and development. Consequently, it is essential that the Japanese government and industry redouble their efforts to ensure that this recent slide is reversed and that steady progress is again resumed. This progress toward an increased U.S. and other foreign share of the Japanese market is deserved solely on the basis of competitive merit.

Explanations for the Success of the Semiconductor Agreements

Despite the recent drop in the foreign share of the Japanese semiconductor market, the 1986 and 1991 Semiconductor Agreements have delivered some real progress in increasing foreign access to the Japanese semiconductor market. Foreign share has increased about 10 percentage points since the 1986 Agreement was signed, an increase that has led to about $2 billion in additional U.S. sales annually.

In light of current developments between Japan and the United States in the trade policy arena, clearly there are some questions that should be asked and answered. Why were the two Semiconductor Agreements more successful than most other approaches to gaining access to the Japanese market? Was it just the inclusion of a target? Is the 1991 Semiconductor Agreement a model for all other sectors?

The inclusion of an objective was key to the relative success achieved in semiconductors. The 20 percent objective was a benchmark against which progress could be measured. It is in fact the measure by which businessmen often judge success. Pepsi and Coke do not just look at their absolute sales but at their market shares to determine if they are succeeding in the market or not. The same is true of newspapers, television stations, and most other big, highly competitive businesses. Living with Japanese competitors that sold their goods in and from a closed home market sanctuary would put American firms at a permanent and disastrous competitive disadvantage. Moreover, Japan was the world's largest market for semiconductors. It supplied the U.S. with our VCRs and laptop computers and a host of other products. To cede Japan its own

market would have been tantamount to accepting the decline of the U.S. semiconductor industry.

A word is in order about what the 20 percent meant and why it was chosen. It is not a guarantee. But it is the key indicator as to whether progress is being made, because the U.S. was and is so competitive. Why this particular number? Because 20 percent of the Japanese market could not be obtained by purchases by just the big, vertically integrated Japanese customer-producers that control the Japanese market. American companies would of necessity have to have sales into the rest of the Japanese market (the pure consumer companies) if the 20 percent were to be satisfied. But what other reasons justify this approach?

First, the U.S. semiconductor industry is highly competitive. Although U.S. firms currently are limited to only 15 percent of the Japanese semiconductor market, U.S. firms outcompete Japanese firms in all other world markets. In Europe, for example, the U.S. share is 50 percent, whereas the Japanese share is only 13 percent. In all world markets outside of Japan, the U.S. share is 56 percent, whereas the Japanese share is only 24 percent. There is no doubt that the U.S. share alone of the Japanese semiconductor market would be far higher than 20 percent if that market was open to free and fair competition. Add to this sales by firms from Europe, Korea, and Taiwan, and the figure would be even higher.

Second, the U.S. semiconductor industry has made the effort required to increase substantially its share of the Japanese semiconductor market. Since 1986, U.S. semiconductor companies have opened more than 60 new sales offices, manufacturing

facilities, design centers, and test/quality centers in Japan. Currently, U.S. companies have 77 sales offices, 22 design centers, and 40 quality test centers, failure analysis centers, and manufacturing facilities in Japan. In all, 125 U.S. companies have a presence in Japan. In addition, since 1986, the SIA Board of Directors has held one of its quarterly meetings in Tokyo every year. SIA is not aware of any other U.S. trade association that annually meets outside the United States with the objective of increasing exports to a single foreign market. In 1988, SIA opened an office in Tokyo, with support from the U.S. Department of Commerce, to coordinate inter-industry contacts, trade seminars, technical tours, and literature exchanges.

Third, the two governments and industries have put an enormous amount of effort into working to implement the two agreements. Both sides have given this issue high priority over the years and have viewed semiconductors as one of the key product sectors affecting bilateral relations. There are officials in both governments whose primary assignment has been Japanese market access for semiconductors since the 1986 Agreement was negotiated. Senior officials have also given their attention to this issue.

Since 1991, SIA has expanded the extensive inter-industry market access program that it developed with the Electronic Industries Association of Japan (EIAJ) under the 1986 Agreement. Working with EIAJ's Users Committee of Foreign Semiconductors (which is composed of purchasing officials from more than 60 Japanese electronics companies), SIA has sponsored a number of committees, seminars, publicity programs, trade missions, and exhibitions to increase foreign sales in Japan. Japanese industry has also invested very substantially in this effort.

Inter-industry activity devoted to increasing market access in Japan exceeds that of any other industry seeking full access to the Japanese market. U.S. companies semiannually submit confidential individual Market Promotion Plans to the two governments and to Japanese customers detailing their efforts to sell in Japan, while Japanese companies submit Market Access Plans to the two governments and U.S. companies detailing efforts to increase purchases of foreign semiconductors. Foreign companies also developed a list of priority semiconductor products and Japanese customers developed purchasing "inquiry" lists that contributed to increased foreign share.

Fourth, the U.S. Congress and three U.S. Presidents have enforced the 1986 and 1991 Semiconductor Agreements. When progress was not forthcoming, the U.S. Government acted -- the sanctions announced by President Reagan in 1987, the Senate Finance Committee's 1992 request for a review of compliance, and the Bush Administration's finding of noncompliance in 1992 all were followed by immediate increased access for foreign semiconductor suppliers. In fact, one of the central lessons of the struggle to gain additional access to the Japanese semiconductor market is that progress depends on the Japanese Government and industry being fully aware of the full commitment of the U.S. Government to enforcing agreements.

Thus, numerical targets were not the sole element by any means for the relative success in semiconductor market access. But the numerical targets in the 1986 and 1991 Semiconductor Agreements have enabled the U.S. Government to assess what could objectively be seen as tangible progress. (The Agreement specifically states that in

measuring progress "particular attention should be given to market share.") Without numerical benchmarks, negotiations are much more likely to yield a long dialogue and activities that do not lead to increased foreign market share.

Fifth, unlike many U.S. industries, U.S. semiconductor companies are not selling directly to end markets in Japan, but rather to electronics customers that then sell finished products to consumers. The U.S. auto industry, for example, faces a very different set of problems in increasing its share of the Japanese market given that it is selling directly to Japanese consumers.

Other industries will have to make a judgment as to whether numerical targets like those contained in the Semiconductor Agreements would work well for them. One caveat is that market share makes particular sense for the sale of industrial intermediate products -- that is, sales to industrial consumers, particularly in a highly concentrated buyers' market. In many ways, as noted above, the semiconductor case is specialized. On the other hand, numerical benchmarks in principle allow the U.S. Government to insist on real progress in increasing foreign market share. History has shown that without objective criteria, real progress in opening the Japanese market is unlikely. A primary reason that Japan has refused to include numerical benchmarks in the Framework negotiations is that benchmarks were used to put pressure on Japan to open the Japanese semiconductor market in a quantifiably ascertainable fashion.

Benchmarks alone, however, will not lead to increased foreign access to Japanese markets. There also must be a variety of other factors present, which I have outlined above -- concerted efforts by the U.S. industry, a high priority of the two governments to

achieve progress, and continued resolve by the U.S. Government to enforce the terms of the agreement.

That concludes my testimony. On behalf of SIA, I thank the subcommittee again for the opportunity to share my views. I would be pleased to answer any questions.

Mr. SPRATT. Thank you very much, Mr. Wolff.

Mr. Gridley, could I ask your forbearance for just a minute, because Mr. Card has to go, and I was supposed to have gone straight to him for a couple of questions that we need to complete for the record.

Mr. Card, I will also turn to Mr. Horn. I am sorry for this disorder, but we want to get as much on the record as we possibly could. What is a good agreement from the standpoint of the Big Three in the U.S. auto industry?

Mr. CARD. What would the agreement be that we would like to see?

Mr. SPRATT. Yes.

Mr. CARD. We would like to see quantifiable measures of access to the Japanese market. There are only two ways to measure the results. One measurement comes in the trading relationship, what is the trade surplus on their side or the deficit or our side; and the other way to measure success is how many vehicles are sold in the marketplace, what is happening in the marketplace.

Mr. SPRATT. What are the quantitative goals that you are seeking? Have you actually laid down some requests?

Mr. CARD. We have. We believe that it is appropriate for us to say that market access can be measured only if we are able to say that we have sold approximately 120,000 cars in their marketplace 3 years from now. That is a relatively arbitrary number, and it is not meant to be a ceiling; it is meant to be a floor.

If that 120,000 unit opportunity in the marketplace is available to the consumers—no guarantee that they buy them but a guarantee that we have access to the consumers with good value at a competitive price—we believe the consumers will respond and buy that number of vehicles. That would imply that the pipeline to the consumer has been freed of the barriers that exist today. That includes problems with certification, problems with the dealership network, and problems with the import restrictions that exist either in practice, or because of past practices and biases, or because of government action.

Mr. SPRATT. Of those barriers, certification would be the easiest to dismantle because it is within the realm of the government completely. I know there are implicit practices and customs that are ingrained and are not written down, but still the government could issue a decree and wipe the slate clean of many of these encumbrances at the border itself or at the ports of entry. Have you made proposals for the specific dismantling of the onerous certification conditions?

Mr. CARD. We have made specific proposals, but I want to be careful. Incremental gains and progress on certification or dealership networks will not produce meaningful results. The results can only be measured by what happens in the marketplace. Right now, barriers to the Japanese market cost the equivalent of a 50-percent markup on our product by the time it reaches the consumer. The MOSS report says that is not gouging due to the barriers that exist.

That 50-percent markup means that our products are not available to Japanese consumers at a competitive price. We meet their demand on quality, we know we offer good value, we know that we

have the style of product that the Japanese consumer would like to buy. We just cannot get it to the consumer. So the only way to measure success is by measuring access to the marketplace, not along the pipeline to the marketplace.

That is why we are careful to say, "Don't just take the barrier of certification down." Don't just say, "We will give you 10 more dealerships." We want to see what happens in the marketplace, and 120,000 units of successful sales in the marketplace 3 years from now is the best measure of all of the progress that has to be made in tearing down barriers.

Mr. SPRATT. What can the government do by legislation or by regulation to loosen the restrictions that keep you from getting into the dealer networks in the major cities of Japan?

Mr. CARD. Again, I think it is important that we hold the Japanese accountable for the same kind of goals that were established in the semiconductor debate. It is a results-oriented package. We have to see measurable results. Again, it should not be a debate over the number of certified vehicles allowed into a marketplace, or the number of dealers that might offer a product.

The Japanese have unlimited access to our dealership network in the United States. They have self-certification of their vehicles, as Mr. Prestowitz talked about. We do not have those resources available to us in Japan. More importantly, we have no access to the consumer in the marketplace so that we can manage by objective. The Japanese manufacturers manage by objective, predicting market sales in the marketplace. We do not even have the resources to be able to do that because their system is closed.

Mr. SPRATT. Do you think that American antitrust law is an available tool for you to break down the dealer restrictions in Japan?

Mr. CARD. I am skeptical that it will produce the kinds of results that we believe it could because of how the antitrust laws work on this side of the Pacific. Our laws do not apply in Japan. If Japanese manufacturers are doing business in the United States with their transplant operations and parts, I think there is a long arm that can reach.

When it comes to the dealership network, while there is a strong financial relationship between Japanese manufacturers and dealers, there usually is not a corporate entity that shows up on this side of the Pacific. So I am skeptical, although our lawyers will certainly look at it and be glad to look at it with other antitrust experts. I am skeptical of our ability to crack the relationship between dealers and manufacturers in Japan to provide us equal access to the consumer.

Mr. SPRATT. One of your principal members, GM, its CEO John Smith, was quoted as saying that the realignment of the value of the yen and the dollar "has done more to level the playing field than all of the government negotiations over the last 20 years." Does that say more about the lack of achievement in government negotiations than it does about the value or the utility of realigning the currencies?

Mr. CARD. In practical terms, the value of the yen has determined what has happened in the U.S. marketplace. We have learned from the Japanese. We are producing a better product in

a more competitive way, and we are now competing in the U.S. market very well, in part because our products are better, our competition or ability to meet the competition is better, but also because the value of the yen is so strong that we are able to put our product in the marketplace a little bit more competitively than otherwise.

That is not necessarily the solution on the Pacific side. The market in Japan is closed. It used to be that we said it was closed, and the Japanese said it was not. This objective report, the MOSS study, paid for by taxpayers in both countries, has concluded absolutely that their market is closed.

All of the other industrialized markets in the world find market access penetration from imports between 20 and 55 percent. In the Japanese market, our products have less than 0.5 percent of the marketplace. All imports combined—European, Scandinavian, Asian, and United States—amount to only 3 percent of the market access.

I was intrigued by the discussion about the Germans. If you look at the vehicles that the Germans are selling in Japan, they are BMW's, and Mercedes, all high-end market products. They are left-hand-drive vehicles, not right-hand-drive vehicles, for the most part. They represent a niche market in Japan. The Germans are not happy about market access in Japan.

What we are looking for is market access that will not just benefit the United States but market access that will benefit the Japanese consumer and our ability to compete. The Japanese consumer has virtually no choice in the marketplace when it comes to imported vehicles. American consumers have broad choice of all vehicles. We think Japanese consumers deserve the same kinds of choices that American consumers have.

Mr. SPRATT. Thank you, Mr. Card.

Mr. Horn.

Mr. HORN. Thank you, Mr. Chairman.

Mr. Card, I appreciate your testimony. It was very thorough and well organized. Let me ask you the question I asked the previous panel.

U.S. automakers have not done enough to get into the Japanese market is the argument. You have mentioned a number of things where that is myth and so forth. Let me read it to you.

> It took Toyota 20 years and two oil crises to be a player in the U.S. market. U.S. automakers have declined to build right-hand-drive vehicles for the Japanese market, insisting they could not do so unless guaranteed a market share, but they have not focused on the market in which they wish to compete. For example, 80 percent of the Japanese cars have engines smaller than 2,000 cc's. There is no American car that has an engine that small, I am told. So already, 80 percent of the market has been conceded even before you consider that the Big Three don't make right-hand-drive vehicles in large quantities.

What do you say to that?

Mr. CARD. Mr. Horn, I have heard literally that same banter from Japanese Government officials and Japanese automobile manufacturers. It does not reflect reality. America's car companies are producing vehicles that are completely acceptable to the Japanese driving environment.

The Jeep Cherokee is in the Japanese marketplace right now as a right-hand-drive vehicle. General Motors and Ford have been

making right-hand-drive vehicles in non-U.S. facilities for some time; the Opel from GM of Germany; and we also have Ford products out of Australia and Great Britain. They have not been able to gain access in any significant numbers to the Japanese market.

Ford is planning to build three products and introduce them to the Japanese marketplace as early as this year; the Ford Probe, the Ford Taurus, and the Ford Explorer. The Jeep Cherokee is there, the Grand Cherokee will also be going there as a right-hand-drive vehicle, and General Motors is planning to produce a right-hand-drive Saturn.

I visited a Toyota dealership in Tokyo called Toyapet, kind of a spontaneous visit right in downtown Tokyo. I walked into the dealership and asked the manager of the dealership if he was able to sell imported vehicles, not U.S. vehicles but able to sell any imported vehicles. He responded, "Oh, no. Toyota would not let me." That relationship with the manufacturer is precluded by law in this country. He could not sell, or at least he did not think he could sell, imported vehicles in his showroom.

There was a Japanese consumer there who was, in theory, looking to buy a car. I asked if he would consider buying an American-made car. He said, "Yes, but." The buts were they do not have right-hand drive, and they are too big for our roads.

Literally right behind this consumer was a Toyota Crown. The Toyota Crown is larger than a Ford Taurus. Ford Taurus will be available as a right-hand-drive vehicle. The next vehicle behind this Toyota Crown was a Toyota Forerunner, which is larger than a Jeep Cherokee, which is now available in the Japanese market as a right-hand-drive vehicle.

We do have products that are acceptable to the Japanese consumer. We do have products that meet the driving environment in Japan. With regard to the 2 liter engine, as was stated earlier, Japanese tax laws discriminated against vehicles over 2 liters. That tax law has changed. Now the marketplace is freer, and I think there are great expectations on Japanese consumers to have vehicles bigger than 2 liter vehicles.

But we would like to be able to compete in their marketplace as it best suits good management in the United States. Business decisions: We do not have the ability now to make good business decisions in Japan, because the barriers prevent us from reaching consumers, even in terms of measuring what consumers might want to buy. That clearly has to change.

Ford is ready to compete. General Motors is ready to compete. Chrysler is ready to compete. In fact, Ford has already started running television ads in the Japanese marketplace for their vehicles, but we do not have a dealership network that reaches enough consumers to justify the normal expenses required to have broad consumer appeal.

Mr. HORN. Let me ask, just on Chrysler's Neon and GM's Saturn, those are both very much heralded, are they going to be available in right-hand drive to your knowledge?

Mr. CARD. Yes. Both General Motors and Chrysler have indicated that they will be producing—in the case of GM, the Saturn, and Chrysler, the Neon—as right-hand-drive vehicles. As consumer market opportunities expand in the Japanese market, I think you

will find that there would be more investments in Detroit made to produce and find suitable right-hand-drive vehicles for the Japanese marketplace.

I do not want to leave the impression that the Japanese consumer only looks at right-hand-drive vehicles. There are a lot of left-hand-drive vehicles sold in the Japanese marketplace today, and there are many Japanese who prefer a left-hand-drive vehicle, kind of as a status symbol. Clearly, the majority of the market is a right-hand-drive vehicle.

I would like to see the Japanese consumer make the choice as to what vehicle they want—right-hand drive, left-hand drive, big, small, or whatever.

Mr. HORN. You mentioned the dealer networks, and that obviously is a key factor in terms of gaining market access. A lot of people have chided the Big Three for their lack of investment commitment to Japan. Looking at this figure, 1993 profits earned by GM, Ford, and Chrysler presumably totaled about $7.4 billion.

The question would be, what percentage of this profit could be invested in dealer networks in Japan? Are you solely limited to existing dealers, in trying to make the deal of the second car choice, or if you break through that bureaucracy and the Japanese Government's intransigence, could you create your own dealer networks?

Mr. CARD. I am pleased that you have noted that America's car companies made profits last year. It was a long time coming, and it was the fourth quarter that really produced the significant results. So we are on the winning side of the revolution today.

In terms of commitment to expanding dealership opportunities in the Japanese market, the MOSS report identifies the challenges in creating a new dealership network. They are formidable. In fact, they are probably the most formidable barrier to market access that was identified in the MOSS report.

The Germans, BMW, did make a commitment to go in and try to build a dealership network. They invested over $120 million, and they found they have not been able to get a return on their investment at all. The costs are prohibitive.

Dealerships in Japan are not the same as dealerships in the United States. First of all, land is very expensive, and dealerships in Japan are closer to the consumer than dealerships traditionally are in the United States. For example, you can go out and find a large tract of land, where they have an "auto mile" in the United States. In the United States, that is the common place to go purchase a car. In Japan, it is kind of around the corner in a smaller, tighter building. It may be a three-story or a five-story dealership going up, rather than 2 or 3 acres of land. So it is very different.

We find that it would be much more realistic for us to have access to the existing dealership network, where dealers could enter into agreements with our manufacturers the same way Japanese manufacturers are able to enter into dealership agreements here in the United States. That is clearly the preferable way to go.

Ford has had a relationship where they have tried to open what is called Autorama dealerships. Those dealerships are not prime dealerships in Japan. The Nissan deal, which was talked about earlier today, was announced before it was real in Japan. If you take a look at the numbers, and it was announced with great fan-

fare that the Nissan dealers would start selling Ford products, it limits it to about 4,500 vehicles a year. That clearly is not significant access to their marketplace.

Mr. HORN. Before you leave, let me ask one more question. This is not directly relevant to Japan, but it is relevant to sales to some of us here or abroad. That is the airbag. To what degree was that going to be put on foreign cars?

The Horn family has waited since 1988 to see two airbags in the front seat, not just protecting the driver and letting the spouse go to the afterworld, but to protect both. When is this going to happen in Detroit?

Mr. CARD. As you know, the airbag is entering the marketplace faster than it was required by law. Safety now sells, and we are finding that safety sells——

Mr. HORN. Some of us knew that 10 or 20 years ago. I am glad Detroit has found that out.

Mr. CARD. It is a reality. It is funny, the Japanese safety obligations in vehicles are not as mature as our safety obligations. I was surprised to see that the safety enhancements that are commonplace on United States vehicles and Japanese vehicles in the United States market are not commonplace in the Japanese market.

I think safety will sell in the Japanese market the same way it sells here. So I actually think that our airbag deployment system would be very attractive to the Japanese consumer.

Again, the best decisions are made when you can have access to a marketplace and truly understand it. America's car companies want access to the Japanese marketplace so they can better understand the Japanese consumer, and they will produce products that the Japanese consumers want. I think the Japanese consumers will want the same safety enhancements that American consumers are now looking for.

Mr. HORN. Thank you.

Mr. SPRATT. Thank you very much. Mr. Card, thank you very much indeed for coming in.

Mr. CARD. Thank you, Mr. Chairman. I appreciate your understanding that I have to go give a speech.

Mr. SPRATT. Absolutely.

Mr. Gridley, thank you for your forbearance. The floor now is yours. We are looking forward to finding out what that is you have sitting in front of you.

## STATEMENT OF DAVID D. GRIDLEY, DIRECTOR OF SALES AND GOVERNMENT AFFAIRS, THE TORRINGTON CO., ACCOMPANIED BY LEE KADRICH, WASHINGTON REPRESENTATIVE, AUTO PARTS ACCESSORY ASSOCIATION

Mr. GRIDLEY. On behalf of the Torrington Co., I wish to thank the chairman for the opportunity to testify on the Japanese-United States trade negotiations concerning auto parts.

Joining me this morning for questions is Lee Kadrich from the Automotive Parts and Accessories Association, which the Torrington Co. is a member.

My testimony this morning will focus on three areas: Torrington's experience with unfair trade competition in bearings in the United States market, Torrington's experience in penetrat-

ing the Japanese auto parts market in Japan, and Torrington's experience in penetrating the Japanese transplants in the United States market.

The Torrington Co. is the largest broad-line producer of bearings in the United States. In addition, Torrington is a major producer of auto parts, such as steering intermediate shafts, entire steering columns like I have here—which are both right and left-hand-drive steering columns; that is not a major engineering problem. Transmission park rods and engine overhead cam shafts are part of our automotive parts line.

The United States bearings market is a $4.5 billion market. Forty percent of this demand is in the auto industry, primarily in the drive train, such as engines, transmissions, and wheels. Bearings are clearly auto parts. Foreign corporations control 60 percent of the U.S. bearing market today, up from 25 percent in 1980. Real U.S. bearing consumption in units has declined by about 40 percent since 1979. Shrinking U.S. bearing shipments are partially attributable to the increased imports of motor vehicles and driveline components with bearings embedded in them.

The estimated value of these automotive-related imports is over $250 million per year. In addition, the United States runs a $407 million trade deficit on bearings with Japan. For example, their imports into the United States were $440 million in 1992. Exports from the United States to Japan were $33 million. This gives you a total imbalance, with the embedded figure I mentioned, of around $657 million.

Worldwide, there is over capacity in the bearing industry, some of which is caused by the dislocation in the auto industry. Seven companies dominate production of bearings, each with plants in several countries, including the United States, beyond their home markets. These companies include NTN, NSK, KOYO, and Minebea of Japan; SKF of Sweden; and FAG and INA of Germany.

The U.S. bearing industry has been the subject of relentless foreign dumping since the 1970's. There have been repeated dumping cases on tapered roller bearings in 1974 and 1987 and on all other bearings in 1988. There are few industries that have been so investigated for predatory unfair pricing, selling below cost, and benchmarking of United States versus foreign prices as the bearing industry. The analysis was done by the Department of Commerce and used actual competitors' data. Dumping persists on ball and tapered roller bearings with margins of 5 to 35 percent by these major producers.

In addition to the dumping remedies, the U.S. Department of Defense has a Defense Federal Acquisition Regulation, called DFAR, that requires the Department of Defense to buy U.S.-produced bearings due to the importance of the bearing industry to national security. Unfortunately, DFAR applies only to 10 percent of the bearings consumed in the USA, far less than the 40 percent consumed by the auto industry. The DFAR was instituted in 1988 through Federal action and congressional initiatives, which characterized the industry as on the precipice of collapse. During the decade of the 1980's, the U.S. industry had lost 30 factories and over 13,000 employees.

In January 1993, the Department of Commerce study on the reauthorization of the DFAR highlighted the state of the bearing industry. I would like to submit, Mr. Chairman, a copy of that report for the record.

[The report entitled "National Security Assessment of the Antifriction Bearing Industry" is in the subcommittee files.]

Mr. GRIDLEY. Some of the highlights of this report on the bearing industry were, No. 1, that foreign dumping and subsidies resulted in massive plant closures in the 1979 to 1987 time period. The dumping cases brought by the Timken Co. and the Torrington Co. have resulted in $1 billion in new capacity since 1989. A significant part of the new investment belongs to the foreign interests racing to avoid the dumping duties. The capacity lost in the 1970's and 1980's is being replaced in the 1990's. The major difference will be substantially greater foreign ownership and weakened capital structure of the remaining U.S. companies.

No. 2, the foreign-owned U.S. bearing transplant operations, in aggregate, are not solvent in the United States. Evidence suggests that they are lowering prices below cost to take market share or maintain market share they already took from the U.S. producers.

No. 3, foreign-owned companies have used the financial borrowing power of their parent organizations to build an asset base that allows them to secure market share, regardless of uneconomical consequences. There appears to be substantial likelihood of foreign-owned companies engaging in faulty transfer pricing that may raise concerns under U.S. tax and trade laws.

This description of the scenario of events in the bearing industry could be characterized as a microcosm of the plight of the U.S. auto parts industry. Maybe some of the solutions in bearings, such as dumping action, should be the same for the auto parts industry.

I will now shift to the Torrington Co.'s experience in penetrating the Japanese auto market. In 1963, the Torrington Co. entered into a 50/50 joint venture with NSK Corp. in Japan to manufacture needle bearings. Torrington provided technical know how, capital, and local management, while NSK provided sales and marketing, local plant management, and capital.

We are happy to say that this has been one of the longest and most successful joint ventures between Japanese and American companies in Japan over 30 years. This venture is primarily focused at the Japanese auto industry for needle bearings. Products are produced at three NSK-Torrington factories in Japan. There are regular engineering and factory exchanges between our personnel in the United States and Japan. Through NSK-Torrington marketing, Torrington feels it has access to the Japanese auto companies' engineering and purchasing management.

This has been particularly helpful as the Japanese auto transplants have attempted to raise U.S. needle bearing content in order to meet U.S. local content goals as part of NAFTA. Today, NSK-Torrington Japan is a successful $200 million venture, with over 35 percent of the Japanese market for its products. However, on products other than needle bearings that Torrington produces and sells through other channels in Japan, we have not been successful in penetrating the market.

We will now shift to Torrington's experience in penetrating the Japanese transplants in the United States. Torrington is a major supplier of needle bearing products to automatic transmission and engine applications. The transplant operations only started producing high-value-added transmissions and engines when the local content goals made it necessary to move these components to the United States. Honda has been at the forefront of moving driveline components to the United States.

Torrington successfully pursued and won over $5 million per year in business on the transmissions made in Marysville, OH. There were substantial obstacles to overcome on quality, tooling, and pricing, which Torrington overcame. Our ability to communicate with Honda in Japan was critical. Torrington looks forward to further business at Honda USA and other transplants as they move to produce high-value, high-paying jobs, generating the driveline components in the United States. Higher local content goals in the Japan-United States auto trade negotiations would encourage that trend.

The Torrington Co. also manufactures steering gear half shafts, which connect the steering gear to the column, in the United States for the Big Three who manufacture their own complete steering columns. We also manufacture complete steering columns in Europe for Ford of Europe, who manufactures both right and left-hand-drive units.

In an effort to penetrate the Japanese auto transplant production in the United States, Torrington found that many transplants used complete steering columns supplied by several Japanese companies, one being NSK Corp. It proved difficult to penetrate the transplant through our U.S. operations.

Later, Torrington and NSK formed another 50/50 joint venture, in Bennington, VT, in 1988 to manufacture steering columns for the Japanese transplants. The relationship is the reverse of the NSK-Torrington venture on needle bearings in Japan. NSK provides technical know how, capital, and the manufacturing process. Torrington provides U.S. marketing, local management, and capital. NSK provides access to the customers in Japan for engineering contacts.

The venture started out by assembling components from Japan. Due to economic and Japanese transplant incentives to meet NAFTA local content goals, local content now stands at 56 percent in 1993 and will be over 95 percent in 1995. I would stress that Dr. Bergsten's comments are proving true in this case; there is a great economic incentive to move the components to the United States on this product line.

Mr. SPRATT. And I guess NAFTA, with its domestic content requirements, will hasten that?

Mr. GRIDLEY. Exactly. Both things have had a major effect.

The venture in 1993 was profitable with sales of over $80 million employing 400 Vermont workers and other workers at Torrington USA factories, some of which are in South Carolina and our other U.S. parts suppliers. Torrington considers NASTECH a successful model of auto parts trade with Japan. However, Torrington has experienced the difficulty found by other U.S. auto parts suppliers,

trying to penetrate the transplants without our joint Japanese relationships.

It should be noted that auto parts are a large basket of components. We speak of them in broad terms, but the reality is, there are things like steering columns, bearings, and specific items. In order to eventually address the auto parts deficit, we must look at specific categories of parts and specific United States and Japanese competitors.

We mentioned several successful openings in needle bearings and steering columns, facilitated through long relationships in Japan. Since the deficit is so serious and requires immediate action, may I suggest the following:

Continued focus on measurable goals for Japanese purchase of auto parts from the United States, contained in their prior agreements.

Second, agreement on higher local content goals for Japanese transplant operations, consistent with their home market practice that would result in the U.S. production of the drivetrain.

Lastly, a dispute panel of Japanese and United States technical experts that could review specific U.S. proposals for auto parts business in Japan and at the transplants for conformance to specifications and to assure the Japanese counter offer is not below cost.

Thank you for this opportunity to testify, and I will be happy to answer your questions along with Lee Kadrich.

[The prepared statement of Mr. Gridley follows:]

**Testimony of Mr. David D. Gridley**
**Director of Sales and Government Affairs**
**The Torrington Company**

**Before the**
**U.S. House of Representatives**
**Committee on Government Operations**
**Subcommittee on**
**Commerce, Consumer and Monetary Affairs**

**February 24, 1994**

On behalf of The Torrington Company, I wish to thank the Chairman for the opportunity to testify on the Japanese - U.S. trade negotiations concerning auto parts. My testimony this morning will focus on three areas:

- Torrington's experience with unfair trade competition in bearings in the U.S. market.
- Torrington's experience in penetrating the Japanese auto parts market.
- Torrington's experience in penetrating the Japanese transplants in the U.S. market.

The Torrington Company is the largest broad line producer of bearings in the United States. In addition, Torrington is a major producer of auto parts such as steering intermediate shafts, entire steering columns, transmission park rods, and engine overhead cam shafts.

The United States bearing market is $4.5 billion. 40% of this demand is in the auto industry, primarily in the drive train, i.e. engine, transmission, and wheels. Bearings are

clearly auto parts. Foreign corporations control 60% of the U.S. bearing market today up from 25% in 1980. Real U.S. bearing consumption in units has declined by 40% since 1979. Shrinking U.S. bearing shipments are partially attributable to increased imports of motor vehicle and driveline components with bearings embedded in them. The estimated value of these automotive related imports is over $250 million/year. In addition, the U.S. runs a $407 million/year trade deficit on bearings with Japan in 1992 or a total imbalance of $657 million.

Worldwide there is overcapacity in the bearing industry some of which was caused by dislocation in the auto industry. Seven companies dominate production of bearings, each with plants in several countries, including the U.S., beyond their home market. These companies include NTN, NSK, KOYO and Minebea of Japan, SKF of Sweden, and FAG and INA of Germany. The U.S. bearing industry has been subject to relentless foreign dumping since the 1970s. There have been repeated dumping cases on tapered roller bearings (1974 and 1987) and all other bearings (1988). There are few U.S. industries that have been so investigated for predatory unfair pricing, selling below costs, and benchmarking of USA versus foreign prices as the bearing industry. The analysis was done by the Department of Commerce and used actual competitor data. Dumping persists on ball and tapered bearings with margins of 5% to 35% by major producers.

In addition to the dumping remedy, the U.S. Department of Defense has a Defense Federal Acquisition Regulation (DFAR) that requires DOD to buy only U.S. produced bearings due

to the importance of the bearings industry to national security. Unfortunately, the DFAR applies to only 10% of bearings consumed in the U.S., far less than the 40% consumed by the auto industry. The DFAR was instituted in 1988 through federal action and Congressional initiatives which characterized the industry as "on the precipice of collapse." During the decade of the 1980s, the U.S. industry lost 30 factories and 13,000 employees.

A January 1993 Department of Commerce study on the re-authorization of the DFAR highlighted the current state of the industry, i.e.:

- The foreign dumping and subsidies resulted in massive plant closures in the 1979-87 time period. The dumping cases brought by The Timken Company and The Torrington Company have resulted in $1 billion in new capacity since 1989. A significant part of the new investment belongs to foreign interests racing to avoid the dumping duties. The capacity lost in the 1970s and 1980s is being replaced in the 1990s. The major difference will be substantially greater foreign ownership and weakened capital structure of remaining U.S. companies.
- Foreign-owned U.S. bearing transplant operations in the aggregate are not solvent. Evidence suggests they are lowering prices below costs to take market share from U.S.-owned producers.
- Foreign-owned companies have used the financial borrowing power of their parent organizations to build an asset base that allows them to secure market share regardless of uneconomical consequences. There appears to be

substantial likelihood of foreign-owned companies engaging in faulty transfer pricing that may raise concerns under U.S. tax and trade laws.

This description of the scenario of events in the bearing industry could be characterized as a microcosm of the plight of the U.S. auto parts industry. Maybe some of the solutions in bearings, such as dumping actions, should be the same.

Torrington's Experience in the Japanese Auto Market:

In 1963, The Torrington Company entered into a 50-50 joint venture with NSK Corporation to manufacture needle bearings in Japan. Torrington provided technical know how, capital, and local management while NSK provided sales and marketing, local plant management, and capital. We are happy to say that this has been one of the longest and most successful joint ventures between Japanese and American companies in Japan. This venture is primarily focused at the Japanese auto industry for needle bearings. Products are produced at three NSK-Torrington factories in Japan. There are regular engineering and factory exchanges between our personnel in the USA and Japan. Through NSK-Torrington marketing, Torrington feels that it has access to the Japanese auto companies engineering and purchasing management. This has been particularly helpful as Japanese auto transplants have attempted to raise USA needle bearing content in order to meet U.S. local content requirements.

Today NSK-Torrington Japan is a successful $200 million venture with over 35% of the Japanese market for its products. Products other than needle bearings that Torrington produces and sells through other channels in Japan have not been successful in penetrating the market.

Torrington's Experience in Penetrating the Japanese Auto Transplants:

Torrington is a major supplier of needle bearing products to automatic transmission and engine applications. The transplant operations only started producing high value-added transmissions and engines when the local content requirements made it necessary to move these components to the USA. Honda has been at the forefront of moving driveline components to the USA. Torrington successfully pursued and won over $5 million/year in new business on transmissions made at Marysville, Ohio. There were substantial obstacles to overcome on quality, tooling, and pricing which Torrington overcame. Our ability to communicate with Honda in Japan was critical. Torrington looks forward to further business at Honda USA and other transplants as they move to produce high value, high paying jobs generating driveline components in the USA. Higher local content requirements in the Japan - U.S. auto trade negotiations would encourage that trend.

The Torrington Company also manufactures steering gear half shafts, that connect the steering gear to the column, in the USA for the Big 3 who manufacture their own complete steering columns. In an effort to penetrate the Japanese auto transplant production in the USA, Torrington found that many transplants used complete assembled columns supplied

by several Japanese companies, one being NSK Corporation. It proved difficult to penetrate the transplants through U.S. operations. Later Torrington and NSK formed another 50-50 joint venture in Bennington, Vermont in 1988 to manufacture steering columns for the Japanese transplants. The relationship is the reverse of the NSK-Torrington venture on needle bearings in Japan. NSK provided technical know how, capital, and manufacturing process. Torrington provides U.S. marketing, local management, and capital. NSK provides access to the customers in Japan for engineering contacts.

The venture started out by assembling components from Japan. Due to economic and Japanese auto transplant incentives to meet NAFTA local content goals, local content now stands at 56% in 1993 and will be over 95% in 1995. The venture in 1993 was profitable with sales over $80 million employing 400 Vermont workers and other U.S. workers at Torrington USA and our U.S. parts suppliers. Torrington considers NASTECH a successful model of auto parts trade with Japan. However, Torrington has experienced the difficulty found by other U.S. auto parts suppliers trying to penetrate the transplants without our joint Japanese relationships.

It should be noted that auto parts are a large basket of components. In order to eventually address the auto parts deficit, we must look at the specific categories of parts and specific U.S. and Japanese competitors. We mentioned several successful openings in needle bearings and steering columns facilitated through long relationships in Japan. Since the deficit is so serious and requires immediate action, may I suggest the following:

- Continued focus on measurable goals for Japanese purchase of auto parts from the USA contained in prior agreements.
- Agreement on higher local content goals for Japanese transplant operations, consistent with Japanese home market practice, that would result in U.S. production of the drivetrain.
- A dispute panel of Japanese and U.S. technical experts that could review specific U.S. proposals for auto parts business in Japan and at the transplants for conformance to specifications and to assure the Japanese counter offer is not below cost.

Thank you for this opportunity to testify.

Mr. SPRATT. Thank you very much, Mr. Gridley. I suppose the lesson learned from your experience is that it helps to have a Japanese partner?

Mr. GRIDLEY. Yes.

Mr. SPRATT. Has this been the same experience in the semiconductor industry?

Mr. WOLFF. By and large, it has not been. There are instances of joint ventures, but primarily Americans have been selling in the Japanese market themselves.

Mr. SPRATT. In the case of the semiconductor agreement, which is one of the successful models that American negotiators can point to, something that has worked, relatively at least, how did the Japanese Government get the agreement to work? How did they implement progress toward the percentage goals that were set?

Mr. WOLFF. The Japanese Government—in this case, the Ministry of International Trade and Industry—has an office that deals solely with semiconductors in their Information Industries Bureau that works closely with the industry to find out why the foreign product is not being accepted, why doors are closed, and how to open those doors up. There is a very extensive organization of both distributors and a users' semiconductor committee.

It used to be that American engineers or salesmen, and they tend to be the same thing in semiconductors, would call upon a Japanese customer. If they were allowed in the door at all, they met with their competitor, the fellow who designed semiconductors within the Japanese company, and not the user, the consuming part of the company in these big, vertically integrated Japanese companies.

That barrier has been cracked with the assistance of the Japanese Government. So these government officials have been our cheerleaders for market access. I think it is largely because the people who are much maligned nowadays, the bureaucrats at MITI, understand that the United States is the most important customer for Japan and that they have to help some American businesses succeed when there is enough foreign attention focused on a particular sector in the Japanese market. They have been helpful to us.

Mr. SPRATT. Mr. Gridley, we had testimony earlier, I believe it was from Mr. Prestowitz, who said that Honda and Toyota have both indicated that they would like to increase the domestic content of their transplant-produced automobiles to 50 or maybe 60 percent. I was talking to a Honda dealer just a month ago, who said that Honda's objective was in a year or 2 to have the domestic content of the Accord up to 60 percent, which is in some respects better than the so-called American-made automobiles.

He also indicated that if they did that, if the major Japanese automobile manufacturers were able to attain those goals with respect to domestic content, that would take care of 30 to 40 percent, maybe more, of the trade deficit in auto parts.

Mr. GRIDLEY. I am not sure whether those numbers are exact, but it is going to make a major improvement.

One point that I would make is that a lot of the pressure to get the local content up to 60 percent referred to the duty-free status under NAFTA and the Canadian agreement. So there was a goal

there. A lot of the pressure coming now is from the value of the yen.

I would stress again that it is relatively easy for the transplants to get to 60 percent without the drivetrain. If you go above 60 percent, the drivetrain has to come in. It either is the transmission, the engine, or both.

That is in line with what I suggested: Some type of an agreement to move drivetrain components to the United States would raise that number. Maybe the economic incentive of the yen will be enough to do that; I am not sure.

Mr. SPRATT. How big an incentive is NAFTA itself? I believe eventually the domestic content requirement, the North American content requirement, is 62.5 percent.

Mr. GRIDLEY. I know that the transplants all have goals to be at that within the next year or so. Then beyond that, it will be a question of these negotiations and the economic factor of the yen.

Mr. SPRATT. Are you beginning to see tangible results, not only in your own firm but I am sure you are aware of what is happening to other firms, like Timkin?

Mr. GRIDLEY. Yes. I would like to stress that. We were successful in the case of Honda. They are at the leading edge of moving drivetrain components to the United States. We have received inquiries, just in the past 6 months, from two or three other Japanese transplants who are making studies of moving transmissions to the United States, and they want American bearings in the transmissions. That is very positive.

Over in the steering gear line, we have been encouraged to get our local content as high as possible because of the economic factors. Otherwise, we have to ask for a price increase because of a change in the value of the yen.

Incidentally, this steering column I have here is the one from the Honda Civic that is made at the NASTECH factory in Vermont.

Mr. SPRATT. And supplied to Marysville, OH?

Mr. GRIDLEY. It is supplied to Marysville, OH, yes.

Mr. SPRATT. Mr. Wolff, I intended to ask this of all the witnesses, but they are all gone now, and I failed to do it. If we have a trade war, what will it look like? What shape will it take? What kind of sanctions will there be? In particular with respect to chips, we are dependent upon the Japanese for certain semiconductors, and also is the American computer industry dependent upon having a kind of free flow of competition so that they can get our competitively priced chips and keep their end products competitive in world markets?

Do you fear the consequences of a trade war with extensive retaliation, that it might lead to sanctions, that it might preclude sources for American computer manufacturers who need to obtain these semiconductor parts?

Mr. WOLFF. First, the Semiconductor Industry Association is in favor of open markets everywhere, including our own market. We sought and achieved a negotiated elimination of tariffs, including the U.S. tariff even though the European Community would not come along in the mid-1980's. Japan and Canada joined us in that tariff elimination. We were supported in our trade agreement very

strongly by the Computer Systems Policy Project, which consists of the CEO's of the 11 largest U.S. computer companies.

We cannot be healthy long if our customer base is unhealthy. We would not support import restrictions on semiconductors. If any sanctions list is drawn up, we would not want to see semiconductors on that list. We want to see American computer manufacturers healthy and thriving; they are our best customers; and we will compete openly with Japan for their business. That does not mean we can tolerate dumping; there were U.S. antidumping cases in the mid-1980's. We would not support trade restrictions of any other kind on semiconductor imports.

I do not think there will be a trade war. I think there will be skirmishes. I think there will be endless limited conflicts, because Japan is not going to "open up"—and I use the term advisedly. I know Clyde Prestowitz has trouble with using the word "open." We are not going to see free market forces determining competitive outcomes in Japan in the way they do in the United States in our lifetime. I would like to think otherwise, just as I would like to think that appealing to a standard of living increase in Japan or to a consumer movement was going to make a difference. We should do so; but it is not going to make a major near-term difference.

So we are going to have fights. What Motorola experienced requires a response. Whether in the next couple of months the Japanese will come up with that response—their own response that is liberalizing and avoids the imposition of trade restrictions here—we cannot know yet. I hope they do, because we need a trade expanding result, rather than a trade restricting result. I think we will get there.

Mr. SPRATT. What you are saying then is that market access in Japan is the only really viable solution for your industry?

Mr. WOLFF. Absolutely.

Mr. SPRATT. Suppose that at least at the first level of effort, it cannot be obtained without retaliation, without some followthrough on threats that are made. What sort of sanctions can be imposed that would help the industry, help lead to this ultimate solution, without hurting your industry and hurting the users of your end products?

Mr. WOLFF. Where there is no hope of Japanese action to correct market closure, sanctions are the only alternative. And, I am afraid these will have to be unilateral. Most of the barriers we are talking about are not susceptible to resolution in the GATT; the GATT's rules do not apply to restrictive business practices. In semiconductors, if it comes to the need to impose sanctions—and we crossed that bridge once in 1987 when President Reagan imposed 100-percent duties on $300 million worth of Japanese goods—if market share kept dropping in Japan, I think the SIA board would have to actively consider supporting the imposition of sanctions again. I hope it does not come to that.

Mr. SPRATT. Mr. Horn.

Mr. HORN. Thank you, Mr. Chairman.

Mr. Wolff, I was interested in your comments earlier about the obvious national interest of nations, in terms of dispute resolution.

We recently approved the NAFTA agreement. What do you think of the dispute resolution system in that agreement?

Mr. WOLFF. I think there are serious problems with it. Our firm represents the U.S. lumber industry. We have had a series of panel decisions adverse to us. We had three Canadians and two Americans. Two of the three Canadians happened to have contacts, commercial interests, with the Canadian lumber industry. Their decision has now been appealed as of yesterday by the U.S. Trade Representative's office through a so-called Extraordinary Challenge Committee.

These are not panels of standing judges. They are private practitioners or professors of what have you. It is a very uneven process. They do not always know why they are there. It has not been a happy experience. We have taken our Nation's commercial interests and submitted them, in effect, to mediation. There will be plants closing in the United States as a result if we are not ultimately successful. I am very concerned about what the NAFTA dispute settlement process will bring us.

The NAFTA panel process will also cause havoc in terms of the kind of law that will be applied. If you are a domestic petitioner and you have a complaint against Canada, do you get a Canadian-United States pool of law that applies to you? If you complain against Mexico—and in the future, Chile or Argentina or whomever else we have a free trade agreement with—do you get a different series of laws applied for the same circumstances?

I am very concerned that what we have gone to is a system which sacrifices national interests, commercial interests, in the name of harmony. That will cost us in terms of the shape of our economy.

Mr. HORN. There is no question that if you take the analogy to the domestic American scene, labor-management disputes, some would argue that in panels of three or even a single arbitrator, there is a tendency to sort of throw the decisions equally so that you are retained on the panel of arbitrators. That might be a worry.

You will recall in the 19th century, however, there were some rather famous cases of international arbitration. There were the Alabama claims, and a lot of these related to boundary disputes, particularly property, international diplomacy area, more than specific trade. Do you not really give much hope for international arbitration in this century or the next century? We have had much of a century when we did not do much with it.

Mr. WOLFF. I think the rules to be applied have to be very clear. What is wrong with the new GATT system that has just been negotiated in Geneva is that we have absolutely foolproof procedures. We cannot block a panel being formed; we cannot block a panel's decision being adopted. There can be automatic counter-retaliation if the United States employs trade measures against a foreign country outside of the GATT rules. But there are no substantive rules that apply to many of the issues that we are concerned about, restrictive business practices being the primary area of concern.

When the Japanese do not certify our goods on a blanket basis, if they have not promised to do so under the GATT, it is not clear that we could win a GATT dispute settlement panel on this issue.

If we did not prevail, but applied sanctions, we are worse off than if we had not gone to the GATT in the first place.

In the cases where arbitration has worked, there has been a very clear stake. What is in dispute has been narrowly circumscribed—a boundary between one area or another or stakeholders' claims. What is at stake here is the future of an American industry. Are we going to sell cars in Japan; if so, how many? What panel would decide on what basis? What would the rules be? Or on bearings or semiconductors?

Our industries are highly competitive. The United States is as I said earlier, a large country. We are approaching this as if we were a small country. The Canadians like the idea of mandatory dispute settlement with us. The Japanese now like it as well. Why? Because we have leverage. If we exercise that leverage wisely, we will gain from it.

Mr. HORN. As counsel to the Semiconductor Industry Association, you are in a unique position to comment on the workings of that United States-Japan semiconductor agreement. In your judgment, has it been a good model for opening up the Japanese market?

Mr. WOLFF. It has been a good model, but it will not have universal applicability. We are highly competitive. Not every American industry will necessarily be as competitive, vis-a-vis the Japanese competition.

Mr. HORN. When you say "competitive," do you mean marketing or quality control? What do you put under "competitive?"

Mr. WOLFF. Price, service, delivery, quality, in every way, shape, and manner. In automotive products, meaning chips that are destined for use in autos for many years, we had 70 percent of the U.S. market and still close to that, about 60 percent of the European market, but only 1 percent in Japan because the electronics firms that supplied Toyota, Honda, Nissan and the others would not accept American chips, although we had the best semiconductors for those applications.

Historically, it has been said that American firms are not strong in consumer goods. That is the general concept. That is inaccurate in that, first of all, consumer applications are joining with computers in multimedia. That is our strength, and consumer technologies are coming home to us. Digital technologies are where we are strong. It used to be that analog applications dominated the supplying of the consumer base.

We lost to dumping the consumer electronics industry in this country. We do not have a color TV industry, and we do not have a VCR industry. We were not able to sell chips for those purposes; the Japanese, who had the market, would not take them. We were ahead in transistors; the Japanese would not take them.

We have succeeded with the use of targets, and with our own efforts, and with the quality of our products, and with the support of the U.S. Government—by which I mean both Congress and the administration. Others who fall into a similar fact pattern could certainly learn from our experience and benefit from it.

Mr. HORN. Have any problems arisen under that agreement as far as the Japanese are concerned? Are there a lot of things that have evolved that they do not like?

Mr. WOLFF. They do not like the fact that the United States says there is a commitment. When Clayton Yeutter walked out of the negotiations in 1986, when he had just concluded the agreement, he said, "They are firmly committed." They put their agreement, the target, in a secret side letter. I remember Carla Hills saying that the Japanese Ambassador kept complaining that Carla Hills referred publicly to the existence of a secret document. Her response to him was, "I wouldn't have to keep talking about it if you didn't keep denying that it existed."

The Japanese have had a lot of problems with the agreement. They do not like it, but it has worked. The fact is that U.S. firms have closer relationships with Japanese companies. American semiconductors are beginning to be designed into Japanese products, which is what is necessary for acceptance in this particular Japanese market. The resentment, I think, has given way to a willingness to work with us, it is the beginning of a partnership.

This is the hope for the future. If this agreement does not work, there are only two other options. One is to restrict Japanese imports to this country, which we do not want to do; and the other is, as a country, to ignore this form of competition, which we cannot afford to do.

Mr. HORN. The rumors and opinions suggest that because problems have arisen—maybe it has been successful is the main problem—the Japanese are reluctant to extend this type of agreement to other areas. Do you have any feeling on whether that is true or not, in terms of your Japanese counterparts?

Mr. WOLFF. Oh, it is absolutely true. In January, the U.S. Government called for emergency consultations with Japan. They were held on January 17. The Japanese said, "We will meet with you, but there is no emergency. In fact, there is no problem. Because there is no problem, there need be no solution. So no extraordinary measures will be taken. Even though foreign market share is dropping in the Japanese market, we will do nothing further."

Why were they taking that position? My assumption is because they did not want to have an adverse effect on their framework negotiating position, which is that targets are a very bad thing. So it has not been a pleasant experience for the Japanese. The agreement is against their narrow commercial interests. They would rather be self-sufficient in semiconductors.

When we entered into the agreement, we, the foreign producers, primarily Americans, had 8.5 percent share of the Japanese market. We now sell $2 billion more a year to Japan than we otherwise would have without the agreement. They do not like that.

Mr. HORN. What share is it now, in percentage?

Mr. WOLFF. The foreign share is, most recently, 18.1 percent in the last quarter. The share had been 20.2 percent in the fourth quarter of 1992. So we have slipped in the last three quarters. The fourth quarter number will be arrived at by the two governments in mid-March. We hope there will be some improvement.

Mr. HORN. That is very helpful.

Mr. Gridley, let me ask you this question. Are auto parts prices higher in Japan in relation to other prices? In other words, if other prices go up 3 percent, do auto parts go up 10 or 15 percent? What kind of relationship does it have to the rest of the price system?

Mr. GRIDLEY. I am going to defer to Lee Kadrich on this also. My feeling is that they are in the same range as the rest of the commercial items in Japan.

Mr. KADRICH. Yes, Mr. Horn. There was a study that was done jointly by the Commerce Department and MITI back in 1991, a joint parts-pricing survey. It identified tremendous price differences for comparable parts between the United States market and Japan. I can just comment on the difference between the prices of the parts in the two markets.

Mr. HORN. I want to make sure I understand that. You are saying, there were different prices for United States-produced products versus Japanese-produced auto parts products that are comparable?

Mr. KADRICH. Yes, looking at comparable parts. One that sticks in my mind is mufflers: Eight times more expensive in Japan for the same item compared to the United States price.

Mr. HORN. The Japanese-produced product is eight times more——

Mr. KADRICH. Yes.

Mr. HORN [continuing]. On not cost of production but price to consumer?

Mr. KADRICH. That was the price to consumers that they were looking at.

Mr. SPRATT. Could I get clarification? OEM?

Mr. KADRICH. They were looking at aftermarket parts. That was the way they compared both for installation and at retail.

Mr. HORN. There is obviously one question if there is a difference in the prices. You say you see little in relation to the rest of the economy. Is that a reflection of distortions or trade barriers on behalf of the auto parts industry?

Mr. KADRICH. In the case of the automotive and the automotive parts industry in Japan, what it showed us—and I think this was summarized very well by Secretary Mosbacher at the time—was that Japan is a noncompetitive marketplace. In Japan, the Japanese car makers control 80 percent of the aftermarket parts sales and service. That is the reverse of what you would find in the United States.

Because of that control and the fact that the Japanese parts makers are not allowed by the parent, or the controlling Japanese automaker to sell in independent channels, both the car makers and parts makers benefit in the end from having that captive marketplace. The consumer is beholden to them at whatever price they want to charge because there is no alternative source.

That is why you see the tremendous price differentials. The benefit of that kind of control to both the car company and the parts maker in Japan is that it subsidizes their aggressive pricing in the United States.

If I might just point out, that was identified in terms of the Toyota minivan case, where Commerce did some terrific trailblazing work and determined that the dumped Toyota minivans were the sum of dumped parts. In fact, when the Auto Parts Advisory Committee presented their policy recommendations to the Secretary of Commerce and Congress back in 1991, we pointed to pervasive Japanese dumping of auto parts in this country.

Mr. HORN. I just wonder, Mr. Gridley, in your area of the half-column and so forth, are most of your counterpart competition within Japan part of the organization that also includes Toyota or Honda, as the case may be?

Mr. GRIDLEY. Yes.

Mr. HORN. So in essence, what they have is a wonderful trust relationship to make sure their other portions of the integrated system—in this case, integrated both vertically and horizontally—can be passed on and make sure the subcorporation, or whatever it is, is making a very high profit that ultimately has to be reflected in the automobile somehow.

Mr. GRIDLEY. Our competition, for example, at Honda, have a related company that is a competitor, although we do have a portion of the business.

Mr. HORN. Thank you, Mr. Chairman.

Mr. SPRATT. Thank you very much.

Mr. WOLFF. Could I just revert to one issue you raised and comment just briefly further on it?

Mr. SPRATT. Certainly.

Mr. WOLFF. You talked about the likelihood of a trade war. Fred Bergsten and Clyde Prestowitz noted that the administration had not handled its public relations very well, although it was going after the right objectives, namely, results.

Japan has a choice, just like it did in the failed semiconductor consultations January 17, in Tokyo. We asked for more help with respect to other segments of the economy, where we were not doing very well, and the Japanese said, "No." They apparently put out a story, however, to the public that the United States had asked for a new market share goal, and MITI had opposed it. That was totally inaccurate. That never took place. With respect to the framework negotiations of 1½ weeks ago, I got a call late that Friday night from a MITI official who was absolutely elated that Japan had said no.

It is probably true that the administration has misplayed its game in terms of public relations. We look like we are unilateralists and, we look like we make bilateral deals that only favor the United States. We come across as overbearing managed traders. But if Japan pushes the United States into a corner, if it does not provide some results, whatever the format, then our options are narrowed to only one: We have to respond. Then you could see a series of trade actions that would be very regrettable.

This is really very largely in the hands of the Japanese. I do not think we have any option other than to pursue our national commercial and economic interests at this point.

Mr. SPRATT. Thank you for that final reflection. We appreciate it.

Mr. Gridley, Mr. Wolff, and Mr. Kadrich, thank you very much for being here. You have all provided excellent testimony and a lot of grist for our mill. I think we will take it further from here with additional witnesses from the administration in the weeks ahead. Thank you for getting us off to a good start with this excellent record.

[Whereupon, at 12:50 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

# UNITED STATES-JAPAN FRAMEWORK TALKS ON TRADE

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**WEDNESDAY, MARCH 23, 1994**

HOUSE OF REPRESENTATIVES,
COMMERCE, CONSUMER, AND
MONETARY AFFAIRS SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
*Washington, DC.*

The subcommittee met, pursuant to notice, at 10:15 a.m., in room 2247, Rayburn House Office Building, Hon. John M. Spratt, Jr. (chairman of the subcommittee) presiding.

Present: Representatives John M. Spratt, Jr., Marjorie Margolies-Mezvinsky, Gene Green, C. Christopher Cox, Christopher Shays, and Stephen Horn.

Also present: Thomas S. Kahn, chief counsel; Jacquetta N. Teal, assistant clerk; and Marc M. Rose, minority professional staff, Committee on Government Operations.

Mr. SPRATT. I would like to call the committee hearing to order. We have other members who will be arriving on the Democratic side. Our members are still in a caucus electing the acting chairman of the Appropriations Committee. The members on the Republican side will also be arriving momentarily. But we have witnesses who have other things to do today, and in the interest of time we would like to proceed with the hearing.

Today, the Commerce, Consumer, and Monetary Affairs Subcommittee holds the second in a series of hearings to examine United States-Japanese trade, with a special focus on the so-called framework talks. Several weeks ago, this subcommittee heard from a panel of distinguished scholars and industry witnesses which included the former Secretary of Transportation Andrew Card, Fred Bersten, Clyde Prestowitz, and Alan Wolff.

Today, we will hear from a distinguished panel of government witnesses, those who have spearheaded the negotiations with Japan. We also have a second panel of academics who will appear today. We want to explore with both panels all aspects of United States-Japanese trade, but particularly the framework talks because that is where the focus lies right now.

Since Japan and the United States failed to reach an agreement in February, we would like to discuss what should be the next step. I would like to compliment the Clinton administration and our witnesses here today, who are the principal characters in this drama, for the tough stand they are taking in our negotiations.

Our current account deficit reached a 5-year high last year, while our merchandise trade deficit rose by more than a third to a record

$59 billion. Our deficit with Japan represents one-half of our deficit with the entire world. Clearly, we can never eradicate our overall trade deficit until we close the deficit or at least substantially narrow the deficit with Japan.

During the 1980's when I was here, the pundits were fond of telling us that the solution to our trade problems were macroeconomic, principally currency realignment and the dollar was overvalued. But in 1985, our deficit with Japan was $46 billion at a time when the dollar stood at 238 yen. Today, the dollar stands at less than half that, 110 yen, and our deficit with Japan has increased by 30 percent.

In the 1980's and the 1990's, the United States and Japan entered into approximately 29 agreements; so, our macroeconomic policies were not the only solution we pursued. Twenty-nine different agreements were attempted, and yet the deficit has only widened.

No one in the government, nor in the Congress wants a trade war with Japan or any other country. However, no one believes that we can continue to run a chronic deficit of this magnitude with Japan or any other country in the world.

We have these two panels today to tell us what course we should chart in the months ahead in order to come to grips with this most serious problem.

Our first panel will consist of four distinguished government witnesses: Under Secretary of Treasury Lawrence Summers, Under Secretary of Commerce for International Trade Jeffrey Garten, Deputy U.S. Trade Representative Charlene Barshefsky, and Assistant Secretary of State Daniel Tarullo.

Secretary Summers helps formulate international economic policies at Treasury. His areas of emphasis include: G–7 policy coordination, aid for Russia, and general trade policy. Mr. Summers was a chief economist at the World Bank. Prior to that, he was an economic professor at Harvard University.

At Commerce, Secretary Garten oversees four key programs: international economic policy, trade development, United States and foreign commercial service, and import administration. Mr. Garten held a senior post on the White House staff and at the State Department in the Nixon, Ford, and Carter administrations. Before joining the Clinton administration, he was a professor at the Columbia Business School.

Ambassador Barshefsky is responsible at USTR for the Asia-Pacific region, Latin America, and intellectual property rights and investment. Prior to joining the government, she was an international trade lawyer at the firm of Steptoe & Johnson.

Last, but not least, Daniel Tarullo is in charge of economics and business issues at State. Before his appointment, he was international counsel at Sherman & Sterling and also a professor at Harvard Law School.

I want to welcome all of you. It is clearly a distinguished panel. Before we ask you to testify, I would like to turn to our ranking member. Please come up to the witness table. Let me now turn to our ranking member Chris Cox and ask him for any opening remarks he would like to make.

Mr. Cox.

Mr. Cox. Thank you very much, Mr. Chairman. I want to thank you for convening the second of our two hearings on United States trade relations with Japan because I think this is a particularly opportune time to discuss this important issue. I want also to welcome our distinguished panel of witnesses—Ms. Barshefsky, Mr. Summers, Mr. Garten, and Mr. Tarullo—that represent the front line of the administration's negotiating team in trade talks with the Japanese Government. Their inside knowledge of our trade talks should prove invaluable to this subcommittee's deliberations.

I also want to particularly thank Chairman Spratt for convening a second panel of witnesses to testify this morning. It will comprise Dr. William Niskanen, currently the chairman of the Cato Institute, the former chairman of the President's Council of Economic Advisors, a graduate of Harvard University and the University of Chicago, the author of numerous books, articles, and studies, discussing the impact of our trade policy on economics.

We will also hear from Gary Saxonhouse, senior professor of economics at the University of Michigan who has recently appeared before the Woodrow Wilson International Center for Scholars here in Washington, to present his view of United States-Japan trade. He has joined more than 50 economists, including five nobel laureates, in urging the President to reject managed trade as the basis for relations with Japan.

Finally, I would like to add just a few words about the impact of the gathering tension in United States-Japan trade relations is having in my district in southern California. My area, my county, is the second largest trading region in all of California, just behind Silicone Valley, well ahead of Los Angeles. Trade with Japan in my county totals $1.2 billion in exports.

One of the companies in my district, NuGen Systems Corp. knows firsthand the impact that these trade tensions can have on American businesses. As a manufacturer of laser printers, NuGen relies on a Japanese part for its survival. The company had no problem getting its supply of parts until the trade talks broke off. Now, like many other southern California firms, it's relationship with its Japanese suppliers has soured.

The company's director of trade administration noted in a recent magazine article that "When we saw the Motorola action, all of a sudden we saw a change in attitude. We have been practically in a begging situation. We have gone to the United States Embassy in Japan and tried every means we can to have this situation opened for us."

NuGen is not alone. Other companies in my district including Printronics, Kaufax, and Advanced Logic Research remain quite concerned with these heightened trade tensions. Each of us shares the goal of a more balanced trade relationship with Japan.

As we move toward a more open approach, we must ensure that we advantage the men and women in America who depend on trade for their jobs. We should also be cognizant of the impact that the administration's statements may have on politics in Japan. As the chairman says, none of us looks forward to a trade war, since there will be no winners in such a war.

I look forward to hearing the viewpoint of each of our witnesses on these crucial topics, and I thank the chairman.

Mr. SPRATT. Thank you very much, Mr. Cox.

Mr. Shays, if agreeable with you, we will go ahead with our panel. Do you have an opening statement?

Mr. SHAYS. No.

Mr. SPRATT. I think we have the protocol correct, but I also told Mr. Summers in this case I believe practicality is consistent from protocol because you need to be somewhere and leave here by 11:15, therefore we will let you proceed with your statement first, then Mr. Garten, then Ms. Barshefsky, and then Mr. Tarullo, if that's agreeable with the panel.

You have all filed, I believe, prepared testimony. As a formality, I will announce at the outset, if there is no objection, that it will be incorporated as part of the record in its entirety so that you can summarize it, if you see fit.

Mr. Summers, the floor is yours. Thank you for coming.

## STATEMENT OF LARRY SUMMERS, UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. SUMMERS. Thank you very much, Mr. Chairman. I'm glad to have this opportunity. My written testimony, submitted for the record, covers the two areas where Treasury has lead negotiating responsibility: Japan's macroeconomic commitments to strengthen domestic demand and reduce the current account surplus, and the market access discussions in financial services. I would be happy to answer any questions on these areas.

But, I would like to use the bulk of my oral statement to do something different. There has been much criticism of the elements of the framework. One of the questions you asked in your letter of invitation is why the Australians and Europeans have criticized our approach. I think it is time we responded to some of those charges.

First, the most popular charge is the suggestion that the United States is seeking to manage trade or to compel the Japanese Government to guarantee a specific market share for U.S. producers that differs from what would have prevailed in the free market. This is not our approach. We are seeking better market access, not specific market outcomes.

Japan has been making procedural commitments to open its markets literally for decades. Yet, very few would argue that the trade outcomes we see in Japan are the result of a free market or represent what would be achieved if there were no constraints imposed by discriminatory regulation or the market power of dominant producers.

The framework agreement is about getting concrete, credible, and effective agreements that go beyond the agreements we have reached so far and really will open Japan's market and allow foreign producers a chance to compete. This requires getting Japan's Government out of the business of managing markets, so that foreign producers have the degree of access and competitive opportunities that would be available were market forces allowed to operate.

In areas like government procurement where the government makes all the purchasing decisions, in areas like insurance where

regulation is the dominant determinant of who can sell, we are not seeking to manage trade. We are seeking to unmanage trade that has been heavily managed so far.

A second frequent criticism is that the framework is designed to produce special benefits for U.S. producers at the expense of others. This is not our approach. We are seeking commitments from the Japanese on an MFN basis. These efforts will benefit all competitive suppliers to the Japanese market, not just United States firms.

The record shows that many of Japan's trading partners have benefited from our past policies toward Japan. That is true of Australian cattle ranchers; it's true of Korean semiconductor firms; it's true of European financial institutions; and it will be true for the many foreign firms that are poised to benefit from further market opening, which is important worldwide in the sectors now under negotiation in the framework.

A third charge is that somehow the framework undermines the multilateral system by relying on unilateral measures rather than GATT disciplines to resolve trade problems. This, too, is not a credible charge.

The framework addresses primarily measures which are beyond the reach of the GATT. This is true in government procurement where the GATT disciplines are not comprehensive; it's true in insurance where Japan declined to liberalize in the context of the Uruguay Round; and it's true in other sectors where tariffs and the issues covered by the GATT are relatively insignificant, but foreign producers still face a variety of impediments to their ability to compete.

Where the GATT provides a solution to a market access problem, we are required by U.S. trade law to take advantage of that process. We have done so in the past, and we will do so in the future. It was this administration that successfully concluded the Uruguay Round. It was on our watch that NAFTA passed the Congress. No one can credibly challenge our commitment to expanding markets and expanding trade.

We have no intention of retreating behind the walls of protection. We have been prepared to take the political heat that comes from the adjustment costs of economic integration. The United States has been the bulwark of the international free trading system for 50 years. It's time for Japan to demonstrate the same commitment to an open multilateral system.

The final criticism of our approach is that the right things are happening in Japan—deregulation, economic stimulus—that somehow change is just around the corner. Some suggest that we should just sit back and let these things happen rather than involving ourselves.

I think the lesson of experience is that this would be a naive approach. A useful tenet of diplomacy is that it is perilous to make policy based on assumptions about another's intentions. It is more prudent to focus on their capacities and on their actions.

Let's look at the fundamentals of our economic relationship with Japan. When we started to engage with Japan last spring, soon after the President came into office, we designed a policy to deal with two main dimensions of the Japan problem: A large trade surplus shared among each of the major trading regions of the world

that robbed a demand-short world of demand for goods and services, and a distinctly low level of manufactured import penetration in key sectors.

While some progress has been made, these fundamentals have not been fundamentally altered. Japan has much more to do to put in place a credible set of policies to address them. This is true despite the initial efforts of the Hosokawa administration to deregulate. It is also true despite two modest fiscal stimulus packages, that all analysts outside of our government and outside of the Japanese Government agree will do relatively little to revive growth this year or to reduce Japan's large current account surplus.

The Clinton administration has taken an export activist approach to international economic policy. For this strategy to pay off, we need strong demand in our major trading partners, rapidly growing markets, and open access to those markets. These are the objectives we have been pursuing in support of a stronger, more open world trading system, and these are the objectives we will continue to pursue.

Thank you.

[The prepared statement of Mr. Summers follows:]

**TESTIMONY OF LAWRENCE SUMMERS**
**UNDER SECRETARY OF THE TREASURY**
**FOR INTERNATIONAL AFFAIRS**
**BEFORE THE HOUSE SUBCOMMITTEE ON**
**COMMERCE, CONSUMER, AND MONETARY AFFAIRS**
**ON THE U.S.-JAPAN FRAMEWORK FOR A NEW ECONOMIC PARTNERSHIP**
Wednesday, March 23, 1994

Thank you, Mr. Chairman. I appreciate the opportunity to update the committee on the status of negotiations under the U.S.-Japan Framework for a New Economic Partnership.

The Framework was developed to address the two major problems that Japan presents for its economic partners -- large and persistent current account imbalances and the many obstacles that still deny foreign producers effective market access. These are the economic fundamentals of our relationship with Japan.

Let me address the macroeconomic issues first. Japan's persistent global current account surpluses emerged as a phenomenon during the 1980's. The surpluses peaked in 1986-7 (Japan's current account surplus was 4.3% of GDP in 1986), but then fell to 1.2% of GDP in 1990. This decline was due to a period of very strong domestic demand growth in Japan and to the cumulative effects of exchange rate adjustment that had taken place during the 1980's. Soon, however, Japan's current account surpluses began expanding again.

As growth has ground to a virtual halt in Japan over the last two years, the level of Japan's surpluses has topped previous highs, reaching over $130 billion in 1993 (a little over 3% of GDP). Japan's surpluses are now the major asymmetry in the world economy.

These surpluses are neither economically nor politically acceptable in the context of the economic weakness in the major industrial countries during recent years. With worldwide demand feeble and recovery uncertain in many of the major countries, Japan's huge surpluses siphon away demand for other countries' exports. In this kind of situation, huge surpluses are a dangerous invitation to protectionism.

Our goal is to reduce Japan's global current account surpluses, not the bilateral surplus with the United States per se. However, the United States could enjoy substantial gains from a reduction in Japan's overall surplus. The CEA estimates that cutting Japan's current account surplus by $50 billion, to 2% of GDP, could mean $5 to $15 billion in increased U.S. exports -- or 100,000 to 300,000 new U.S. jobs. The net employment increase would likely be less, but, since export-related jobs are generally better paying, there would be additional gains for national welfare.

Over half of the growth in U.S. income and almost all of our growth in manufacturing jobs since the mid-1980's has resulted from export growth. This is why the Clinton Administration is taking a export activist approach to international economics.

But, for our export activist strategy to pay off, we need strong demand for imported goods in other countries and fair, full access to their markets. The United States has supported world growth for decades through its open economy. The Framework is, in part, a recognition that Japan, as the second largest economy in the world, must share the responsibility for promoting world growth.

The Framework embodies medium-term macroeconomic commitments by both sides. Under the Framework, the United States has made a commitment to reduce the federal budget deficit significantly and to promote domestic saving and international competitiveness. Japan has made a commitment to promote strong domestic demand-led growth, to make a highly significant reduction in its current account surplus, and to increase its imports of goods and services significantly.

The United States has already fulfilled its part of the bargain. The Omnibus Budget Reconciliation Act of 1993 -- the largest deficit reduction package in history -- is yesterday's news. We made the hard choices needed to put together a deficit reduction package of over $500 billion. The payoff will be substantial: by FY1995, we will have cut $70 billion from the deficit compared to earlier official projections. At a projected 2.4% of GDP, the 1995 deficit will be the lowest U.S. deficit in relation to GDP since 1979. And, as deficit reduction proceeds, the competitiveness of U.S. producers will improve.

To date, Japan has not lived up to its side of the macro deal. The Japanese government has presented two economic stimulus packages since the Framework was agreed upon in July. The latest package was introduced on February 8th, just before President Clinton's February meeting with Prime Minister Hosokawa.

This most recent package had the largest headline total ever -- 15.3 trillion yen ($145 billion) in various tax cuts and spending measures. But the facts still show a Japanese economy that has yet to begin staging a credible recovery from the most prolonged downturn in Japan's postwar history and stimulus package that is inadequate to turn this situation around.

The recent stimulus package includes a one-year reduction in income taxes. A permanent income tax cut could be a positive step towards rebuilding household confidence and reviving consumption, which is the largest component of domestic demand. But the effectiveness of a one-year tax cut is more limited.

As President Ford discovered in 1975, additional disposable income from a temporary tax cut is more likely to be saved rather than spent. If the tax cut were permanent, and if Japan were to pursue a sustained period of substantial fiscal stimulus, the chances of giving a real boost to domestic demand would be much better.

The Japanese government says it expects the recent package to raise growth to 2.4% in fiscal year 1994. Growth of 2.4% is not all that high, but this figure is considerably more than is expected by most other analysts. The private consensus is that Japan's economy will expand by just 0.3% this calendar year, and by only 1.8% in 1995. Thus, even with the recent stimulus package, the gap between the level of Japan's potential output and its actual performance will continue to widen this year and next.

We are still a long way from seeing the fundamental economic policy changes that are needed to revive growth in Japan and produce a meaningful reduction in Japan's current account surpluses. Private forecasters are expecting a scant $10 billion reduction in Japan's surplus this year. Japan will have to sustain and reinforce its efforts if the current account surplus is to be reduced substantially.

Let me now turn to the area of the Framework that has received a lot of attention: the **market access component**.

Japan has long had a distinctive trading pattern with the rest of the world. For example, since 1982 Japan's manufactured imports averaged 3.1% of GNP, less than half the average for other industrialized countries. A 1991 price survey found that consumer goods were 35-40% more expensive in Japan than in the United States. This difference is too large to be justified by transportation costs alone, and is evidence that access to Japan's market continues to be effectively limited, to the detriment of Japanese consumers and foreign firms.

These pattern have persisted despite the process agreements of the past -- agreements in which the Japanese government agreed to change the rules and procedures that restricted foreign access. In many cases, the actual improvements in access for U.S. firms were less than impressive. That is why, in our view, it is essential that trade agreements under the Framework have objective criteria to assess the effectiveness of the agreements we make.

In the Framework, Japan agreed to identify and undertake specific measures to increase market access of competitive goods and services. In addition, Japan agreed that the implementation of these measures should be assessed using objective criteria.

We have not been able to reach agreements with our Japanese counterparts on what these objective criteria should be. While the February 11 negotiations broke down over this point, I don't think the problem is insoluble.

Despite Japanese claims to the contrary, we have never sought numerical targets in the sense of a single fixed market share goal to be achieved by a given deadline. The recent agreement on cellular telephone systems shows that we can come to an agreement that, as Ambassador Kantor says, is results-oriented and uses "objective criteria that set clear standards for success."

Let me conclude with a few words about an area in which Treasury has primary responsibility -- financial services. I think the problems that we face in getting effective access to Japan's financial markets illustrate the types of issues we are grappling with in our other negotiating groups as well.

Japan's financial markets are among the most heavily regulated and closely managed of any major industrial country. The country's maze of regulations, limitations on activities, and outmoded practices affect all firms, but foreign firms suffer a disproportionate disadvantage.

Let me describe a few of the implications of this regulatory maze for U.S. firms:

-- U.S. and foreign Investment Advisory Companies can compete for only 12% of private pension fund money and none of Japan's public pension fund money.

-- In the area of corporate securities, U.S. firms face a variety of regulations that have inhibit their ability to innovate. This is reflected in the fact that U.S. firms have lead managed only 3% of total assets in Japan's market.

-- In Japan's investment trust (mutual fund) market, the cost of entry is about 30 times that in the United States, and marketing requirements are quite restrictive.

-- Finally, Japan continues to maintain the most extensive capital controls of any G-7 country, impeding the ability of U.S. firms to offer widely accepted, innovative products.

The financial system's basic structure reflects Japan's post-war objective of allocating scarce capital to favored industries at the least cost possible to borrowers. Today Japan's financial markets are still highly segmented and strictly regulated. These conditions have tended to allocate market share among dominant Japanese firms and maintain the profits associated with these allocations. While such a system might have been understandable

in the context of the immediate postwar era, there is no reason that it should continue.

What we are looking for is deregulation to allow a broader diversity of products to be sold, by a broader range of firms and to a broader range of investors. I am convinced that U.S. financial services firms, demonstrated leaders in world markets, would flourish in the Japanese market if open and fair competition, rather than regulation, was the rule.

We have not yet resumed discussions under the Framework. We need to have quantitative indicators in order to assess the implementation of agreements. We will not compromise on this point. I am hopeful that the Government of Japan will recognize this imperative and return to the table prepared to meet it.

At the same time, we are actively monitoring our existing agreements with Japan. We have reached a new agreement on cellular phones. And we are reviewing our other bilateral and multilateral options.

Let me note in closing that these problems are not unsolvable. Given the Prime Minister Hosokawa's commitment to reform -- a commitment strongly supported by the Japanese public -- we have an opportunity to craft some agreements that will reflect and encourage Japan's deregulation efforts while ensuring that U.S. and other foreign firms can get effective access to the Japanese market.

Thank you.

Mr. SPRATT. Thank you very much, Mr. Summers.
Mr. Garten.

**STATEMENT OF JEFFREY E. GARTEN, UNDER SECRETARY FOR INTERNATIONAL TRADE, DEPARTMENT OF COMMERCE, WASHINGTON, DC**

Mr. GARTEN. Thank you, Mr. Chairman. Let me start by saying that I fully endorse everything that Mr. Summers said. I think that it is an excellent overview of the framework, what we are trying to accomplish and why.

I would like to just take a minute to focus in on two issues where the Commerce Department has had particular responsibility. I would like to emphasize that we have worked on the framework as a highly coordinated team in the administration.

The first area where we have spent a lot of time is in the automotive trade arena which includes vehicles and also auto parts. When the summit broke down on February 11, we had a proposal on the table that basically addressed four issues. I would just like to summarize those briefly.

First, we have asked the Japanese Government to take bold steps to reduce the regulations concerning vehicles that are imported into Japan to simply inspection and certification procedures, and also to reduce barriers to the development of the aftermarket for parts, the market for replacement parts.

Second, we have asked the Japanese industry to open up its system for dual-franchise dealerships. The idea being that American companies did not have the same opportunity to sell their products in Japan as the Japanese have in the United States.

Third, we have asked for significant increases in the purchase of parts made in the United States by Japanese vehicle manufacturers, both in the United States and in Japan. And, finally, we asked for a higher level of local content in the United States, a much higher level than now exists.

In all of these areas, it was an essential element of our proposal that there be concrete commitments and that those commitments be measurable so that we could tell whether or not there would be progress as a result of the negotiations, and so we could be sure that these negotiations would not have fallen into the pattern of past agreements where there was an accord only to result in disappointing results.

The second area of significant responsibility for the Commerce Department is in medical technology. Here, we are working under the part of the framework that deals with government procurement. That part is led by USTR. The problem here, I think, is relatively simple. This is an industry which is, without qualification, one of America's leading edge, high technology industries. We have at least 50 percent of the world market, but in Japan we have about 20 percent.

This is a straight question of government procurement practices in Japan which are discriminatory, not open enough, and so we have proposed to the Japanese and we have pressed the Japanese to open their market to our products, to have a market which is much more competitive.

We have asked for intervention from the highest levels of the Japanese Government, and we have also asked them to reconsider their procurement practices in the medical technology area such that the criteria is not just based on price alone but on the overall value, since the nature of our equipment and services is by definition very high value.

These are the two areas where we have put most of our emphasis: Although we have worked, as I said at the beginning, very closely with all the other agencies to inject a viewpoint into the negotiations which, on the one hand, at least allows the American business community to have a channel; and on the other, furthers the administration objectives of more open markets all around the world.

Thank you.

[The prepared statement of Mr. Garten follows:]

TESTIMONY OF

UNDER SECRETARY OF COMMERCE

FOR INTERNATIONAL TRADE

JEFFREY GARTEN

BEFORE THE HOUSE SUBCOMMITTEE ON

COMMERCE, CONSUMER, AND MONETARY AFFAIRS

MARCH 23, 1994

I am pleased to have this opportunity to appear before the House Committee on Government Operations' Subcommittee on Commerce, Monetary, and Consumer Affairs. I would like to bring you up to date on one of the most difficult problems facing us -- our trade relations with Japan.

I will focus on several issues which are of particular concern to the Department of Commerce and to me. First, I will discuss where we stand on our automotive trade and medical technology procurement negotiations with Japan -- issues that Commerce leads under the U.S.-Japan Economic Framework discussions. Following that, I will offer my thoughts on the views expressed by some of our trading partners in Asia on the approach this Administration has taken to U.S.-Japan trade problems. I would like to close with some views on what I perceive as one of the central problems we face when trying to resolve trade problems with Japan -- namely, Japan's apparent inability to take market-opening measures absent constant foreign pressure.

Framework Discussions on Automotive Issues

The automotive sector is one of the most visible examples of closed Japanese markets and the distortions they have caused in international trade flows. Japan is the world's largest exporter of automotive products but has the lowest import market shares for vehicles and parts of any developed nation. Import share for vehicles is less than 3 percent, compared to 35 percent in the United States and a range of 39 to 56 percent in other major markets. Imported parts account for less than 2 percent of the Japanese market, compared to 30 percent in the United States and 16 to 60 percent elsewhere in the OECD.

Although foreign manufacturers face many difficulties competing in the Japanese automotive market, the overwhelming obstacles are the long-standing exclusionary relationships between the Japanese vehicle manufacturers and their dealers and their parts suppliers.

As in many other sectors, the closed distribution system severely hinders access by foreign vehicle manufacturers to the Japanese market. Extremely high land prices and the shortage of suitable sites precludes the establishment of new sales outlets in the major Japanese markets. Selling through existing dealership organizations is the only economically viable choice for new entrants; these dealerships have the land as well as the necessary sales and service expertise. The historic ties between Japanese automakers and their dealers, however, limit access to such distribution channels by competing foreign models. In comparison with the U.S., where dealers commonly negotiate franchise agreements with competing manufacturers, such agreements are virtually non-existent in Japan. We are encouraged by some recent

signs of change in this area but further change is needed.

Similar problems exist in selling auto parts to the Japanese vehicle manufacturers. The manufacturers procure parts from the same suppliers year after year and model after model. These suppliers are typically members of the same "keiretsu," and share close financial and management, as well as technical, relationships. Foreign, or even other domestic parts makers, are seldom invited into a manufacturer's supplier network regardless of competitive considerations. These practices have been extended to the U.S. manufacturing operations of the Japanese automakers who continue to procure a high percentage of their components from keiretsu-affiliated suppliers or joint ventures either in Japan or the United States.

Efforts to crack the Japanese market were for some time also hindered by a perception of a marked difference in quality between U.S. autos and auto parts and Japanese-origin products. Recent data show this perceived quality gap has narrowed. As measured by J.D. Power and Associates' New Car Customer Satisfaction Index, the quality of Big-Three brands has risen from a level of 94 in 1986 to 132 in 1993. This represents an improvement of 40 percent. The index for Asian brands, predominately Japanese, increased 18 percent during the same period, from 119 to 141.

While quality may have been a historical argument for low rates of penetration into the Japanese market, these recent improvements, coupled with the improved price competitiveness of American products as a result of the value of the yen in recent years, should be reflected in higher import penetration in Japan. Yet the exclusionary business practices continue to deny market access to increasingly competitive American firms.

Indeed, the perception of the closed market in Japan itself hampered the efforts of U.S. manufacturers to compete there. Faced with limited opportunities in a high cost market, they were generally reluctant to expend resources on product development, marketing and investment in distribution and technical infrastructure.

At the same time, the U.S. market has remained open to Japanese trade and investment. In this period, we have recorded massive and growing automotive trade imbalances. Over the last ten years the automotive deficit has accounted for well over half of the total bilateral deficit. In 1993 the automotive deficit with Japan increased to $33.4 billion from $31.2 billion in 1992 and is projected to reach $35 billion in 1994.

Previous Automotive Negotiations

For nearly two decades, the two governments have been engaged in efforts to resolve these problems, in close cooperation with our

respective industries. The most recent initiatives include the following:

- Government-to-government discussions have been conducted under the Market-Oriented Sector-Selective (MOSS) Talks on Transportation Machinery and ensuing follow-up talks since 1986.

- The Market-Oriented Cooperation Plan was negotiated in 1990 to consolidate existing and newly proposed programs into a comprehensive plan of action. As part of this Plan, the Government of Japan agreed to provide to the U.S. Government the Japanese auto makers' plans for U.S. procurement and to undertake a joint study of factors affecting the sale of foreign vehicles in Japan.

- A joint Department of Commerce and Ministry of International Trade and Industry price survey of auto parts was conducted in 1991. The prices of surveyed auto parts in Japan averaged 87 percent above the prices observed in the United States, demonstrating the Japanese consumer has been paying a heavy price because of the closed Japanese market.

- The Department of Commerce and Ministry of International Trade and Industry sponsored four auto parts conferences on how to do business with the Japanese vehicle manufacturers. All have been well attended, with the most recent held last year in Dearborn, Michigan, attracting over 500 attendees. A fifth conference is tentatively scheduled for October of this year, also to be held in Dearborn.

- During a Presidential visit to Japan in January, 1992, the two governments announced the Global Partnership Plan of Action. As part of this Plan, Japanese vehicle manufacturers voluntarily undertook individual commitments which collectively would increase their purchases of U.S. parts from an estimated $9 billion in 1990 to $19 billion in 1994. The Plan also stated that on average the Japanese vehicle producers in the United States planned to increase their U.S. content from 50 percent in 1990 to 70 percent by 1994.

These initiatives have resulted in some progress, particularly in the area of parts purchases by the Japanese transplants. Although U.S. content per transplant vehicle has risen, parts imports have continued to rise due to increased transplant production. Content levels, however, remain well below those of the Big Three assembly plants in the United States or, by comparison, the European content of U.S.-owned assembly plants located there.

Very little progress has been made in increasing access to the Japanese domestic market for either parts or vehicles. Years of negotiations have identified the problems, studied solutions, and even implemented promising initiatives. However, results to date have been disappointing, despite the increased competitiveness and marketing efforts of U.S. companies, appreciation of the yen relative to the dollar, and other factors which would be expected to redress the trade imbalance in an open market.

U.S. Industry Efforts

Private sector efforts have been, and will continue to be, crucial to the ultimate success and effectiveness of any Framework Agreement. It is clear to me that U.S. companies are now making strong efforts to develop business in Japan. For example:

- Chrysler introduced a right hand drive Cherokee a year ago in Japan and sales growth has been impressive. Chrysler will begin selling right hand drive versions of the Grand Cherokee and Jeep Wrangler in 1994.

- Ford is improving its existing dealer network and has been actively pursuing new dealers.

- This year Ford will begin exporting from the United States a right hand drive version of the Probe. Within three years, Ford will be building, in the United States, right hand drive Tauruses and Explorers for export to Japan.

- Last July, Ford announced plans to build a $50 million technical center near Tokyo. Ford Motor Credit Corporation began operations in January; the company will extend financing to dealers and customers in Japan.

- General Motors has announced plans to export right hand drive Chevy Cavaliers to Japan beginning in 1996. These cars will be sold under the Toyota nameplate.

- On the issue of vehicle certification, new efforts by the Big-3 are underway. Chrysler has just completed the difficult process of obtaining type designation approval for the Cherokee. GM and Ford have made applications to obtain type approval for more of their vehicles.

- The U.S. Motor and Equipment Manufacturers Association and the Japan Motor Vehicle Manufacturers Association have established a private sector Liaison Committee to promote the development of business relationships. Out of that committee came the agreement to regularly schedule "one-on-one" meetings to develop relationships between individual U.S. suppliers and Japanese

automakers. Both the Liaison Committee activities and the one-on-one meetings continue today.

The U.S. Automotive Proposal

To address market access problems in the automotive sector we have presented the Japanese Government with a comprehensive proposal that focuses on three areas: auto parts sales, vehicle sales, and deregulation. The proposal builds upon previous bilateral automotive agreements, but with a more results-oriented approach.

There are four critical components to the U.S. proposal:

1) Providing access to the Japanese vehicle distribution system through a significant increase in the number of direct franchise agreements between Japanese dealers and foreign vehicle manufacturers;

2) Continuing and improving on the trend of increasing North American content by Japanese manufacturers located in the United States;

3) Continuing and improving on the trend of increasing purchases of foreign manufactured auto parts by Japanese vehicle manufacturers located in Japan and U.S. manufactured auto parts in the United States; and,

4) Achieving significant regulatory reform, deregulation, and simplification of Japanese Government procedures in the areas of standards, certification, and the automotive parts aftermarket.

In addition to these four critical elements, the U.S. proposal also calls for:

- Opening Japanese procurement and design-in processes to foreign auto parts suppliers by providing information about upcoming procurements;

- Expanding Japanese engineering and technical exchanges with U.S. parts suppliers;

- Continuing the trend of increasing U.S. exports from Japanese vehicle manufacturers located in the United States;

- Expanding business relationships between U.S. and Japanese automotive companies in Japan and throughout East Asia; and,

- Stronger enforcement of Japan's antitrust laws with respect to the Japanese automotive industry.

Consistent with the overall Framework Agreement, the U.S. proposal contains multiple quantitative and qualitative criteria for assessing progress. We believe it is critical that we are able to monitor progress and have the capacity to determine whether the goals of this arrangement are achieved. These actions and others suggested by the United States are intended to achieve the objective of "unmanaging" trade by increasing market access and sales opportunities in Japan for foreign automotive products in a manner consistent with our obligations in GATT and elsewhere.

The Government of Japan has not responded favorably to our proposal to eliminate market access barriers in the Japanese market. Japanese counterproposals have focussed on the review of historical data and an examination of the sales efforts of U.S. manufacturers. Their proposals do not recognize or address the underlying impediments limiting access and fail to contain objective criteria by which progress can be measured. Their proposals have been unsatisfactory to us.

Japanese Government Procurement of Medical Technologies

I would like to turn now to another Framework issue -- Japanese government procurement of medical technologies. This falls under the Framework's government procurement basket, chaired by Ambassador Barshefsky, but Commerce assumed lead responsibility for the negotiations at the working group level.

The U.S. medical technology industry is a highly competitive, high-wage, knowledge-intensive industry sector. It is precisely the kind of industry that contributes to quality job growth in the United States. The medical technology industry on the whole is a very successful exporter of manufactured goods. In fact, this is one industry sector in which we have a trade surplus with Japan.

However, there are burdensome and often discriminatory regulations, price-cutting of reimbursement prices focused almost exclusively on devices manufactured by foreign firms, and an incredibly non-transparent procurement process. All this combines to limit the ability of leading-edge medical technology firms to achieve their market potential in Japan.

Currently, foreign firms make up about 27 percent of the Japanese market. U.S. firms alone make up about 20 percent, leaving the lion's share, about 70 percent, for domestic Japanese firms. But in the global market, U.S. firms have a market share of almost 50 percent. In fact, in every developed country, with the exception of Japan, U.S. firms have at least a 40 percent market share.

Now, some may say, "Well, it's only natural that competitive Japanese firms would do well in their home market." And, certainly, there are obvious inherent advantages for firms competing on their home turf. But can these advantages explain why Japanese firms, which struggle to obtain a global market share of less than 10 percent, have such success in their home market? If we determine competitiveness by objective measures, such as market share in third countries and leading firms in the industry, Japan should not have the market share it does.

I have already mentioned the almost 50 percent market share of U.S. firms globally. But even in the European Community, where a number of leading manufacturers of medical technologies are located, the U.S. share is about 40 percent. In addition, of the top 10 manufacturers of medical technologies, 8 are U.S. firms. None are Japanese. In fact, if you look at the top 62 manufacturers, only three are Japanese.

My point is this: it is neither "shoddy American workmanship," nor Japanese competitiveness that explains why U.S. firms can obtain only a 20 percent share in a market where domestic competition is not world class. Clearly, something other than the invisible hand of the market is at work in Japan.

The Framework emphasizes a results-oriented solution to this problem. By reaching an agreement on improving procurement procedures in the government sector, coupled with quantitative and qualitative criteria designed to assess the success of the agreement, we believe we can help foreign firms obtain a share of the Japanese government market commensurate with their competitiveness.

It is important to note that even before the Framework, we tackled some of the impediments to foreign exports in this industry sector. Since 1985, the Commerce Department has been leading negotiations in the Market-Oriented, Sector-Selective (MOSS) talks on Medical Devices and Pharmaceuticals. These talks have focused on specific discriminatory regulatory barriers and have met with some degree of success, although there are increasing attempts by the Ministry of Health and Welfare (MHW) to focus its so-called "cost containment" efforts exclusively on foreign devices.

The Framework negotiations deal with a different, but equally important, aspect of the problem: the discriminatory procurement practices of all Ministries, not just MHW. Some of the problems faced by U.S. negotiators in the Medical Technologies working group were common to most government procurement negotiations, such as privileged access for domestic firms to procurement information, and impossible delivery dates for devices (unless, of course, a firm happened to know before the allegedly "open competition" that it had won the procurement, and could prepare in advance to meet the deadline).

However, we have particular concerns for the medical technologies sector because of the confluence of Japanese regulatory and procurement practices that are aimed at restraining foreign competition, while the Japanese government pursues an aggressive industrial targeting strategy. It is clear that Japan is determined to limit foreign market penetration until a viable domestic industry is in place.

Let me give you an interesting example of this. In 1993, a MITI laboratory solicited proposals for an advanced biomagnetometer, a machine that provides advanced imaging of the human brain. A California-based U.S. firm, (a firm, incidentally, that had successfully managed to convert technology originally used in anti-submarine warfare to medical uses) offered its proven Magnetic Source Imaging device for this tender. In fact, this U.S. firm had already sold a number of systems throughout the world, while its Japanese competitor for the procurement had only a prototype to offer.

Nonetheless, instead of awarding the tender to the U.S. firm, MITI gave the award to the domestic firm. MITI asserted that the Japanese device met the rather unusual design requirements while the U.S. device did not. However, the design specifications stipulated were skewed to favor the Japanese system, and even degraded the ultimate measuring capabilities of the machine.

Even so, in clinical trials and performance tests, the domestic firm's prototype device failed 8 of 10 attempts. And even in the two tests that did not fail outright, the best result was still more than two times less precise than the U.S. system. Nonetheless, despite this poor performance, the U.S. firm lost the procurement.

In sum, rather than buy an existing device from the world leader in the technology sought, MITI instead chose to procure a domestically-developed device that did not even exist as a commercial product at the time of the procurement. I am sure it is no coincidence that the Japanese government will be funding development of this product to the tune of some $50 million.

In our view, a successful medical technologies agreement, with rigorous and transparent procedures that would require the purchase of the most competitive medical device, would at least limit the ability of government entities to create biased design specifications or engage in other actions that would treat unfairly foreign bids. And, in fact, we did make some progress in our negotiations.

For example, Japan agreed to publish in advance procurement information for public hospitals, and to provide a directory of procurement officials for each hospital. This kind of procurement information, if sufficiently detailed, could go a long way toward creating a level playing field for foreign firms.

However, I have read with some bewilderment in the press reports that Japan views our work on medical technologies as almost completed. One unnamed Japanese official went so far as to characterize work on the Med Tech agreement as being "85-90 percent done." This is simply not true.

The failure of the two sides to agree on the issue of quantitative criteria is well known, and our requirement for measurable results is not negotiable. However, leaving aside the quantitative criteria, there are still a number of unresolved issues left on the table.

For example, it is extremely important that procurement decisions be made on the basis of best overall value instead of solely on price. Most competitive foreign, and certainly most U.S. medical technologies, are more sophisticated and offer a higher level of technology than competing Japanese products. In a number of medical device categories, particularly, but not exclusively with more expensive capital-equipment, U.S. medical technologies surpass anything available domestically. And while it is true that these devices may have higher initial purchase prices than Japanese devices, it is also true that, over the life-cycle of the product, their ultimate benefit to the Japanese health care consumer is far higher and their ultimate cost is far lower.

In addition to just being more technologically advanced, it is important to note that U.S. firms almost always include service contracts with the purchase of these devices, while Japanese firms sell these contracts separately. Contrary to some assertions, U.S. firms are committed to the market for both sale and service after purchase. Unfortunately, if a procurement is based solely on lowest-bid, without taking into account the superior features and service offered by many foreign firms, then not only foreign firms, but the Japanese health care consumer will lose.

Another outstanding issue is our request for a Prime Ministerial directive encouraging entities to seek out competitive foreign suppliers. One of the key problems for foreign firms operating in Japan is gaining timely access to procurement information and officials, including doctors and technicians who decide what equipment should be purchased.

Currently, this information is parcelled out in a completely non-transparent fashion. Through "old boy" networks and the like, Japanese firms gain advance knowledge of what is in the procurement pipeline well before official procurement announcements are made.

This leads to procurement decisions for medical devices being made before any official announcement, and, indeed, makes the official procurement nothing but a formality.

In our proposed directive, we are seeking fair access to any advance information and all decision-making officials in the procurement process, as well as official encouragement from the Government of Japan that contacts with foreign firms are to be increased. In effect, we are simply asking Japan to affirm in the medical technologies agreement the purpose of the Framework: "to increase access and sales of competitive foreign goods and services."

In sum, we are seeking to create a fair, open, and non-discriminatory Japanese market for medical technologies.

Concerns of Our Asian Trading Partners

Our intensive efforts to reach agreements with Japan under the bilateral economic framework have engendered much comment from our trading partners in Europe, Asia, and elsewhere. They are concerned that we are trying to negotiate agreements with Japan that will benefit only U.S. firms, and that the Japanese market will become even more difficult for non-U.S. firms to penetrate as a result of these agreements. Nothing could be further from the truth.

These trading partners appear to believe that Japan's capacity to absorb imports is fixed, and that the real competition is for a piece of this limited pie. They are concerned that increased U.S. sales in Japan will come at the expense of their firms. This is not our goal, and this will not be the effect of the market-opening agreements we are seeking to conclude. This is not a zero sum game where one exporter to Japan can only succeed at the expense of others. We want to expand export opportunities for all countries. We know that everyone -- the U.S., Australia, Europe, and Japan -- will benefit from an open Japanese market.

Our goal is one that we all share -- to open the Japanese market so that all firms can compete equally on an MFN basis. The agreements we are seeking are based on that principle -- each agreement is intended to expand opportunities for sales by competitive foreign, not only U.S., products in Japan. Rather than expressing concern, I would hope that our trading partners will join us in our efforts to open Japan's market.

Our Asian trading partners also track U.S.-Japan trade relations very closely. During my recent visit to several Asian countries, I formed some impressions of how Asian nations view U.S.-Japan trade. I would like to briefly share some of those impressions with you.

Asian leaders very much want an increased U.S. commercial presence in their countries. They are greatly concerned about Japan's potential dominance in the region, and there exists a strong sense in Asia that Japanese companies are not willing to sufficiently train local workers, to entrust local employees with key management positions, and to transfer technology.

Many Asian leaders hold the view that the Japanese market is closed to most of their products, except those produced by Japanese subsidiaries in their countries. At the same time, those leaders are concerned that U.S.-Japan trade tensions might spill over and have negative effects on their countries.

I assured these leaders that Asian exporters to Japan will share, along with suppliers of competitive products and services from the rest of the world, the fruits of our efforts to open Japan's market.

Dynamics of U.S.-Japan Trade Negotiations

I would like to offer some closing thoughts on the dynamics of our trade negotiations with Japan. Historically, Japan has been unwilling to take the initiative in opening its market to foreign goods and services. Instead, it has waited until foreign pressure -- "gaiatsu" in Japanese -- has built up before it takes any action. And that action is almost invariably limited to measures that open the market in narrowly defined ways.

Japan has told us in the past that "gaiatsu" is a necessary part of any trade negotiation, and that it is needed before it can take any market opening steps. We are told that Japan's trade negotiators are able to quell domestic political opposition to market opening measures by saying that they had no choice but to respond to foreign pressure. This may help Japan on the domestic front, but it creates problems on the international front. What Japan's reliance on gaiatsu really means is that no issue can be resolved in a non-contentious manner.

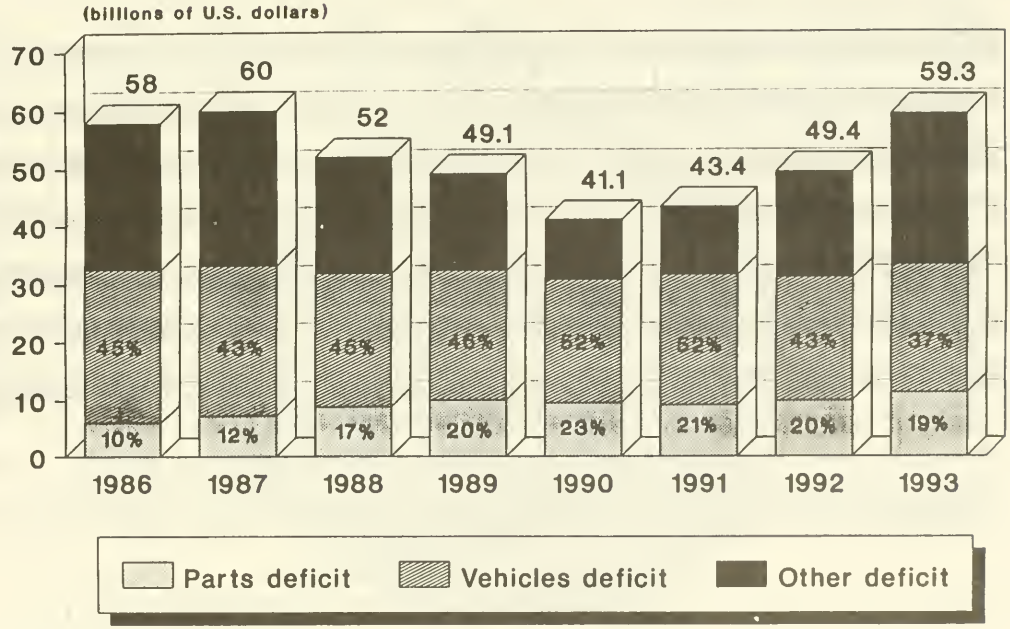
Because of Japan's insistence on this approach, trade negotiations are virtually scripted out. The plot is simple. Foreigners demand access to the market. Japan's trade negotiators hold out, for months or years, as the debate becomes more heated. Finally, the problem escalates to the point of serious confrontation, threatening a major rift if it is not settled. At that point, Japan compromises and a deal is reached. The foreign country is cast as the villain in the script. And Japan's negotiators are the heroes who hold out against overwhelming odds. Frankly, we are tired of seeing reruns of this show.

When this pattern of trade negotiations first became evident in the 1980's, trade negotiators on both sides had a tacit understanding that both sides were in fact following a script and

that there would be no hard feelings after the show. But the play acting has become real. Ironically, Japan now resents the foreign pressure that it once said was a necessary component of any market-opening action. At the same time, the U.S. has learned that it cannot rely on Japan to take any meaningful market opening actions absent intense pressure.

Our desire to develop a new relationship with Japan is reflected in the Framework. But Japan's commitment to reach agreements with us in key areas by the time of the recent summit between President Clinton and Prime Minister Hosokawa has not been realized. As you are aware, we are reviewing all our options toward Japan in the wake of the summit. We continue to believe that the openness of Japan's market is essential if our trade relations are to be put on a healthier basis, and we will continue to focus our efforts on that objective.

# Motor Vehicle and Parts Share of the U.S.-Japan Merchandise Trade Deficit




Source: U.S. Census Bureau

# U.S.-JAPAN AUTOMOTIVE TRADE DEFICIT

(in billions of dollars)

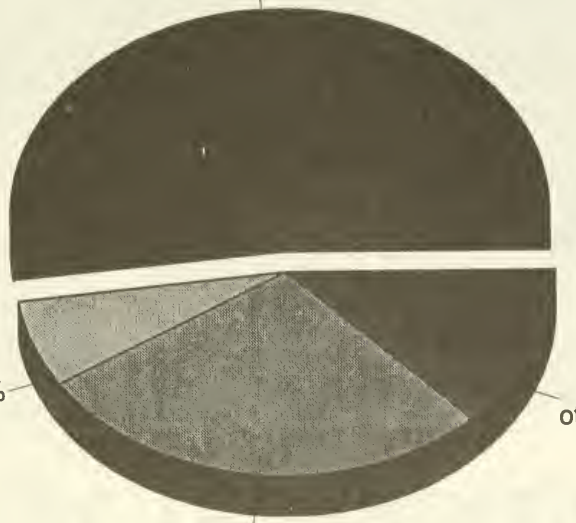
| | | | U.S.-JAPAN AUTOMOTIVE DEFICIT | | | U.S.-JAPAN VEHICLE DEFICIT | | | U.S.-JAPAN AUTO PARTS DEFICIT | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Total U.S. Trade Deficit | U.S.-Japan Trade Deficit | Deficit | Share of Total U.S. Deficit | Share of U.S.-Japan Deficit | Deficit | Share of Total U.S. Deficit | Share of U.S.-Japan Deficit | Deficit | Share of Total U.S. Deficit | Share of U.S.-Japan Deficit |
| 1986 | 138 | 58.6 | 32.6 | 24% | 56% | 26.6 | 19% | 45% | 6.0 | 4% | 10% |
| 1987 | 152 | 59.8 | 33.3 | 22% | 56% | 26.0 | 17% | 43% | 7.3 | 5% | 12% |
| 1988 | 119 | 51.8 | 32.0 | 27% | 62% | 23.1 | 19% | 45% | 8.8 | 7% | 17% |
| 1989 | 109 | 49.1 | 32.4 | 30% | 66% | 22.4 | 21% | 46% | 10.0 | 9% | 20% |
| 1990 | 102 | 41.1 | 30.8 | 30% | 75% | 21.3 | 21% | 52% | 9.5 | 9% | 23% |
| 1991 | 67 | 43.4 | 31.7 | 48% | 73% | 22.6 | 34% | 52% | 9.1 | 14% | 21% |
| 1992 | 85 | 49.4 | 31.2 | 37% | 63% | 21.4 | 25% | 43% | 9.8 | 12% | 20% |
| 1993 | 116 | 59.3 | 33.4 | 29% | 56% | 22.2 | 19% | 37% | 11.2 | 10% | 19% |

Not seasonally adjusted, current dollar basis

Source: Office of Automotive Affairs, International Trade Administration, U.S. Department of Commerce
Compiled from U.S. Bureau of the Census statistics

# U.S. COMPETITVENESS IN MEDICAL TECHNOLOGIES

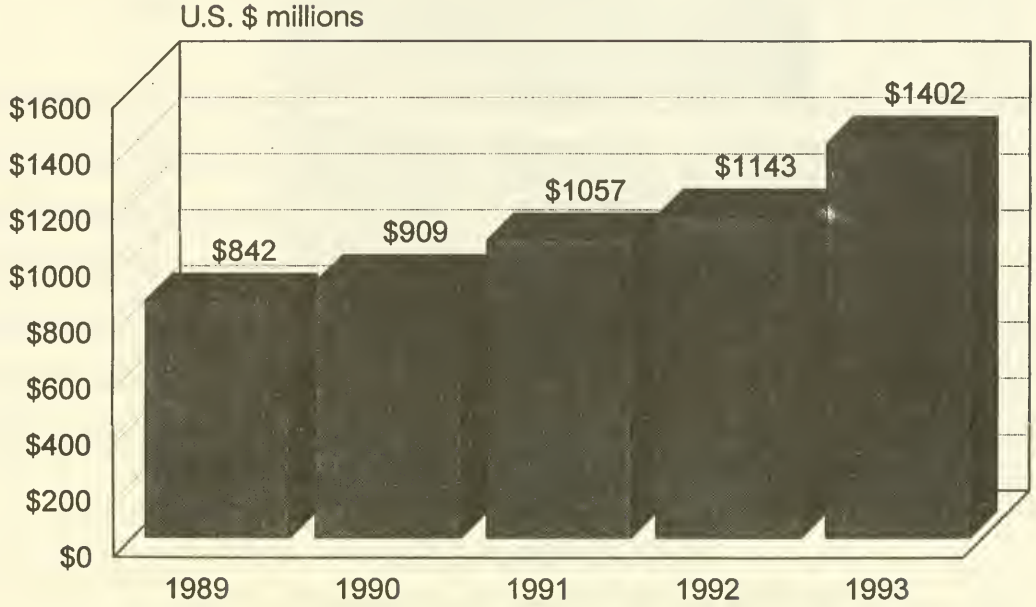
## Comparison of U.S., Japan, and EC Shares of the Global Market




Source: USDOC

# MEDICAL TECHNOLOGIES

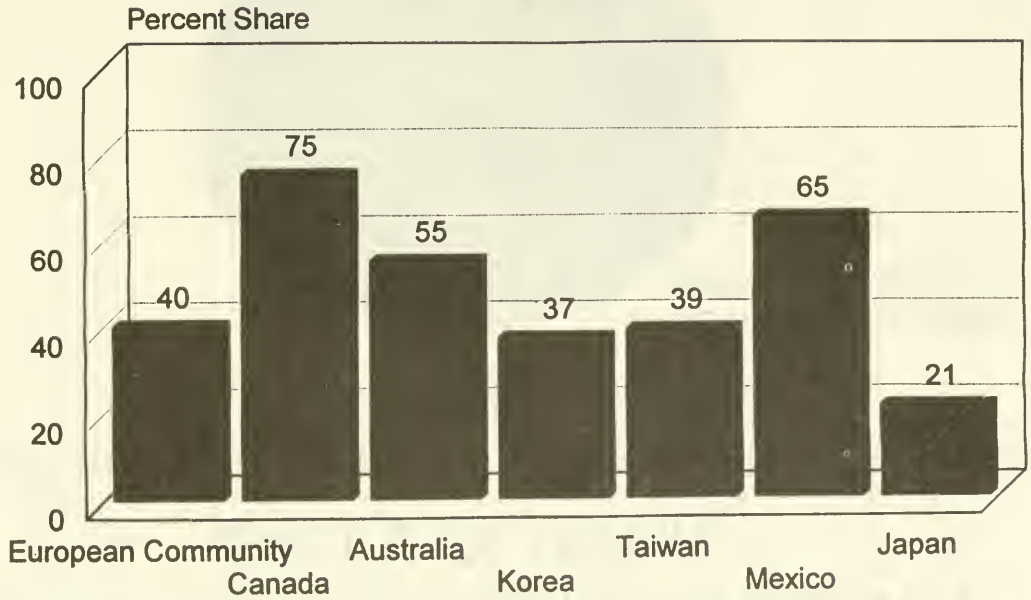
## U.S. Exports to Japan




Source: USDOC

# MEDICAL TECHNOLOGIES

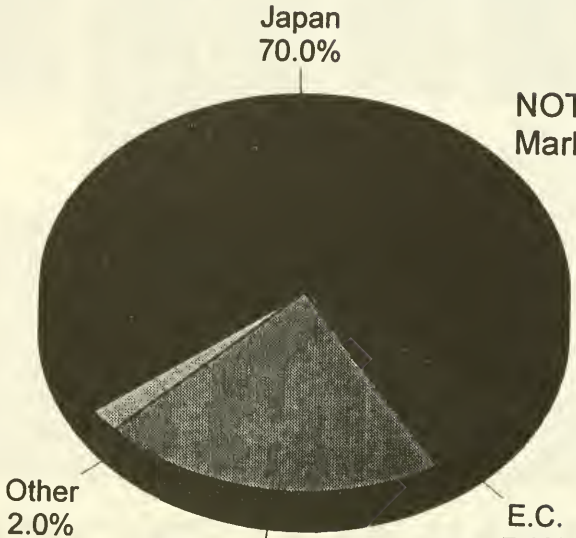
## U.S. Share of Foreign Markets




Source: USDOC

# FOREIGN MEDICAL TECHNOLOGY SALES IN JAPAN

## Comparison of U.S., Japan, and EC Market Shares in Japan




NOTE: Total Japanese Market = $17 Billion

Source: USDOC

Mr. SPRATT. Thank you very much, Mr. Garten.

Ms. Barshefsky.

**STATEMENT OF CHARLENE BARSHEFSKY, DEPUTY U.S. TRADE REPRESENTATIVE, OFFICE OF THE U.S. TRADE REPRESENTATIVE**

Ms. BARSHEFSKY. Thank you, Mr. Chairman. I am pleased to be here this morning to discuss with you and the members of your committee the status of the United States-Japan trade relationship.

The bilateral economic relationship with Japan is one of extreme importance not just for Washington and Tokyo but for the world economy and the world trading system. That is why this relationship together with NAFTA and completion of the Uruguay Round has ranked as a top trade priority for this administration. In all of these areas, our formula has been simple and consistent. The United States is committed to achieving greater economic growth at home and abroad through the opening of foreign markets to trade and investment.

The President stressed the importance of the bilateral economic relationship during his meeting with Prime Minister Hosokawa on February 11. He noted that as the world's second largest economy Japan is a vital, potential partner in our efforts to promote global growth. However, Japan has yet to show that it is prepared to participate fully in such a partnership. As the President also stated, "Japan remains less open to imports than does any other member of the G–7 group of industrialized countries."

The Japanese economy is characterized by a number of barriers to imports of manufactured goods, services, and inward investment. In case after case, United States and other foreign products which enjoy substantial sales in markets outside of Japan, often against Japanese competition, are stymied in efforts to enter and prosper in the Japanese market. That means that U.S. jobs are lost and U.S. exports blocked.

Let me this morning just take a moment to focus on two areas of immediate concern under the framework, government procurement and insurance, two of the areas chaired by USTR. United States and foreign industries which are highly competitive around the world, often against Japanese competition, are often not competitive in Japan.

In 1991, the total foreign share of Japan's market for telecommunications equipment, the third largest market in the world, was 5 percent. In the G–7 countries, excluding Japan, foreign import penetration averages 25 percent.

In medical equipment, as Under Secretary Garten testified, foreign participation in Japan is less than half that in other developed economies, despite a relatively less competitive Japanese industry.

Although Japan has the second largest insurance market in the world, foreign access has consistently been limited to only about 2 percent of the market. Imports of insurance services constitute between 10 and 33 percent of the markets in the other G–7 countries.

In each of these sectors, we saw from the Japanese Government significant procedural and regulatory reform that would lead to increased access and sales in Japan of competitive foreign goods and

services. In telecommunications and medical equipment, our proposals contained detailed provisions to ensure that procurement procedures are open, transparent, and nondiscriminatory through such devices as advanced notice of procurements and limitations on the use of sole sourcing by procuring entities.

In insurance we sought to address serious U.S. concerns regarding the closed nature of the Japanese insurance market. We sought such things as process and procedural transparency, detailed regulatory reform, and competition policy enforcement. In addition, as the United States and Japan had agreed under the framework, in each sector we sought objective criteria, both qualitative and quantitative, as a means of measuring success of the agreements. In addition, we also sought a variety of datapoints.

During the negotiations, we made some limited progress on procedural and regulatory reform. But, as February 11 approached, there were still very significant differences in these areas. Equally troubling, Japanese negotiators failed to acknowledge in any meaningful way the key principles our two governments had agreed on last July: Results orientation, that is, the need for tangible progress in the marketplace in Japan; and measurement through the use of objective criteria.

The Japanese negotiating position, as Under Secretary Summers has alluded, on these issues was confined, essentially, to one statement: no managed trade. This was a public relations device intended to label the U.S. position as unreasonable. It was not an accurate statement of the U.S. position. The U.S. goals in these talks has been to unmanage the most managed major economy in the industrialized world. This goal is shared by many of Japan's other trading partners and many Japanese.

Under our framework talks, the United States proposed not fixed market share targets, but sets of qualitative and quantitative criteria that in the aggregate would permit us to assess implementation of each agreement and whether procedural reforms lead to expected changes in the marketplace.

Following the February 11 talks, but unrelated to them, the administration on February 15 determined that Japan had not complied with the 1989 agreement to open its cellular telephone systems market to U.S. manufacturers of cellular equipment. The determination resulted from a clear cut failure of Japan to live up to a government commitment to grant comparable access to the Japanese cellular systems market. Our previous efforts to open this market spanned almost a decade and include two government-to-government agreements and a letter of commitment.

We were to have published a preliminary sanctions list on March 17. However, on March 12 the United States and Japan agreed to a detailed series of actions to be put into place in Japan over the next 21 months that will ensure completion of the cellular system and comparable market access for U.S. equipment vendors.

Mr. Chairman, our experiences in this sector reflect broadly on the frustrations we have encountered in a number of our bilateral trade agreements with Japan and our determination to pursue results-oriented agreements. We have concluded over 30 trade agreements, as you noted, since 1980.

As in the cellular telephone sector, we have had to come back to the table again and again, often raising the very same issues covered by operative agreements. Examples include: Glass, paper, wood, computers, supercomputers, semiconductors, and construction. If we are to achieve real market access in Japan, we must see more than agreements. We must see change in the marketplace.

Mr. Chairman, we are on new ground in our trade relationship with Japan. We view this, though, as an opportunity to restore balance and confidence in our economic ties. We would like to see these ties as strong as those which bind our political and security relationship. We believe that the leadership in Tokyo shares this view. While we are assessing our options in the trade area, the administration's approach to Japan will continue to be responsible, deliberate, and conscious of our shared concerns as well as our difficulties.

The Japanese are also reassessing their position. We understand that the Japanese Government is preparing proposals on a range of unilateral market-opening measures to be released later this month, some of which may seek to address framework issues. We encourage this activity and support fully the Japanese Government's steps at deregulation, but we must see bold and aggressive action by Japan with respect to market access.

As the President told Prime Minister Hosokawa, "Our door remains open to meaningful proposals from the Japanese with respect to framework issues. But in the end, it is the Japanese market which must be open."

We look forward to working closely with you, Mr. Chairman, and with the members of the committee as we pursue this goal.

Thank you.

[The prepared statement of Ms. Barshefsky follows:]

**Status of U.S. - Japan Trade Relations**

**Testimony to the House Committee on Government Operations Subcommittee on Commerce, Consumer, and Monetary Affairs**

**Ambassador Charlene Barshefsky**
**Deputy U.S. Trade Representative**

**March 23, 1994**

Mr. Chairman, I am pleased to be here this morning to discuss with you the status of the U.S. - Japan trade relationship. The bilateral economic relationship with Japan is one of extreme importance, not just for Washington and Tokyo, but for the world economy and for the world trading system. That is why this relationship, together with NAFTA and completion of the Uruguay Round, has ranked as a top trade priority from the outset of this Administration. In all of these areas, our formula has been simple and consistent. The U.S. is committed to achieving greater economic growth at home and abroad through the opening of foreign markets to trade and investment.

The President stressed the importance of the bilateral economic relationship during his meeting with Prime Minister Hosokawa on February 11. He noted that as the world's second largest market, Japan is a vital potential partner in our efforts to promote global growth. However, Japan has yet to show that it is prepared to participate fully in such a partnership. As the President also stated, Japan remains less open to imports than does any other member of the G-7 group of industrialized countries.

The President made these remarks during a press conference with Prime Minister Hosokawa on February 11. The comments of the two leaders focussed primarily on the inability of the U.S. and Japan to resolve a set of negotiations on four sectors -- Japanese Government procurement of telecommunication and medical technology; insurance; and the automotive sector; which had been taking place over the previous six months under the U.S. - Japan Framework Agreement. We tried until 4:30 a.m. on February 11, at the level of Ambassador Kantor and Japanese Foreign Minister Hata, to move the negotiations toward resolution. Ultimately, the Administration decided against concluding last minute agreements that would have papered over our differences with Japan and on the need for Japan to take credible action to address its global trade imbalances. It was an unprecedented decision, but as the President said, the issues between Japan and the United States are so important for our own nations and for the rest of the world that it was better to have reached no agreements than to have reached empty agreements.

I want to first review the nature of the economic imbalances which lead us to seek major changes in the bilateral economic

relationship, and how we are trying to address these imbalances under the Framework. I would then like to comment on some of the specific sectoral negotiations which were the focus of USTR activity under the recent negotiations. I would also like to comment on activity in the telecommunications sector concerning the determination that Japan had not complied with the Third Party Radio and Cellular Telephone Agreement of 1989. As you are aware, this issue was resolved on March 12, in a manner which has significant implications for broader trade concerns.

While we recognize the breadth and scope of Japan's economic achievements since the end of the Second World War, it is also evident that the Japanese economy performs in a manner which sets it clearly apart from the other major industrialized countries in general and the G-7 in particular. This is evident when looking at the macroeconomic dimensions of the problem; at Japan's massive current account surplus, which now constitutes the major asymmetry in the world economy today; and at its comparatively low levels of inward direct investment and imports of manufactured goods.

Among the OECD countries, Japan accepts by far the lowest level of the global stock of inward direct investment; just 0.7 percent, as compared to 38.5 percent in Europe and 22 percent in the United States. Many economists point out that trade follows investment; this vast discrepancy in investment stock in Japan limits the ability of U.S. and foreign firms to use this channel to increase export flows.

In 1991, manufactured goods imported by the U.S. accounted for 6.9 percent of GDP, an average of 7.4 percent for the rest of the G-7, excluding Japan, but only 3.1 percent for Japan. Among the G-7 nations Japan also ranks consistently low in measures of intra-industry trade. Intra-industry trade refers to the tendency of most industrialized economies to import products similar to the products they export. One measure of intra-industry trade based on 1990 data calculated that 58 percent of Japan's trade were in exports and imports within the same product category. The comparable figure for the U.S. was 83 percent, those of the European members the G-7 averaged 73 percent. Japan's low level of intra-industry trade is consistent with other evidence pointing to the relatively closed nature of Japanese markets.

In case after case, U.S. and other foreign products which enjoy substantial sales in markets outside of Japan are stymied in efforts to enter and prosper in the Japanese market. Sectoral barriers against foreign products and services in Japan raise problems for the U.S. quite apart from any concerns over our bilateral trade deficit. They affect our domestic economy by limiting the composition of our trade with Japan -- by telling us in what sectors we can and cannot export. These practices deny

the U.S. and other foreign countries the benefits to be expected under an open global trading system. Output and jobs in our most competitive sectors are lower than they would otherwise be because of Japanese practices. We must address these sector specific barriers in the Japanese economy in order to enhance the volume and quality of our exports and export related jobs.

This Administration was determined from the outset to respond firmly and effectively to these economic imbalances. The need to address both macroeconomic and sectoral/structural issues was reflected in the U.S. - Japan Framework Agreement, agreed to by President Clinton and then Prime Minister Miyazawa in Tokyo in July 1993.

Under the macroeconomic portion of the Framework, Japan committed to pursue objectives promoting sustained demand-led growth and increased market access for competitive foreign goods and services leading to a highly significant decrease in its current account surplus over the medium term, and to promote a significant increase in global imports of goods and services. The macroeconomic dialogue is being conducted largely in the context of ongoing G-7 discussions.

USTR has been primarily responsible for various sectoral and structural aspects of the Framework. Under the Framework, the U.S. and Japan committed to seek new agreements in four priority areas prior to the February 11 meeting between President Clinton and Prime Minister Hosokawa. As I have noted, these sectors are Japanese government procurement of telecommunications and medical technology; insurance; and automobiles and auto parts. USTR chaired the government procurement area, and led the insurance talks for the U.S. side. We held intensive negotiations in these areas from September 1993 until February 11.

Let me describe for you the problems we face in the areas of Japanese Government procurement and insurance. In each, highly competitive U.S. and foreign industries are extremely under-represented in the Japanese market. For example, in 1991 the foreign share of Japan's market for telecommunications equipment -- the third largest market in the world -- was five percent. In the G-7 excluding Japan, foreign import penetration averaged 25 percent. In medical technology, Japan hosts an uncompetitive domestic industry which holds about 70 percent of its home market while only seven percent of the world market. An extremely vigorous U.S. industry which has more than a 40 percent market share in the foreign markets outside of Japan is limited less than half that in Japan. And although Japan has the second largest insurance market in the world, foreign access has perennially been limited to only about two percent of the market. Imports of insurance services constitute between 10 and 33 percent of the markets in the other G-7 countries.

In light of these discrepancies, the U.S. tabled proposals in telecommunications, medical technology and insurance. In telecommunications, our proposal contained provisions to ensure that procurement procedures are open, transparent and non-discriminatory, such as advance notice of procurements and limits on the use of sole sourcing by procuring entities. We made it clear to the Japanese that the closed nature of the Japanese market in this key sector was unacceptable, particularly given the global competitiveness of U.S. and other foreign telecommunications companies.

In medical equipment, the U.S. draft included specific provisions to improve the procurement of medical devices and services by Japanese Government entities. In particular, the U.S. proposal called for the widespread use of the best overall value approach in evaluating bids to ensure access for more costly but cost effective technologically advanced U.S. equipment. We also sought fair and transparent access to the procurement system for all categories of medical products and services, including expensive capital equipment and relatively low-end, low-price products in which U.S. competitiveness is also clear.

In insurance, we sought to address serious U.S. concerns regarding the closed nature of the Japanese market. Limited foreign access is caused by, among other things, a non-transparent regulatory regime based on extensive use of "administrative guidance"; a highly concentrated industry structure; "keiretsu" and cross-shareholding arrangements; and a highly restricted insurance product approval process which limits innovation. The Japanese Government is aware of the need for change and is currently in the process of drafting legislation to reform its insurance industry. Our negotiations sought to ensure that this process of reform resulted in real transparency in the marketplace, and yielded real access for our innovative industry.

These sectors are each very different, and I would be reluctant to generalize too broadly the degree to which the negotiations paralleled each other. In general, however, what we sought from the Japanese Government in each sector was procedural reform that would lead to significant increases in access and sales in Japan of competitive foreign goods and services: the "tangible progress" that was called for in the Framework. Also as the two governments had agreed to under the Framework, we sought objective criteria, both quantitative and qualitative, as a means of measuring the success of the agreements. Finally, these new agreements were to have been entered into on a most favored nation basis; the dividends of increasing openness would be available all of Japan's trading partners which are competitive vendors in these sectors.

During the negotiations, we made some limited progress on procedural reform, but as February 11 approached there were still

significant differences in these areas. More troubling, Japanese negotiators failed to acknowledge in any meaningful way the key principles on which our two governments had agreed last July -- results orientation, that is, the need for tangible progress -- and measurement through the use of objective criteria.

The Japanese negotiating position on these issues was confined essentially to one statement: "no managed trade targets". This was a public relations device intended to label the U.S. position as unreasonable. It was not an accurate statement of the U.S. position. Our goal is to unmanage the most managed major economy in the industrialized world. This goal is shared by many of Japan's other trading partners and by many Japanese. Rather than a single, fixed market share goal to be achieved by a given deadline, we proposed from the outset a set of qualitative and quantitative criteria, that, in the aggregate, would permit us to assess implementation of each agreement and whether procedural reforms led to expected change in the marketplace. The Japanese approach, was essentially to disavow the very Framework principles to which both governments had agreed.

Following the February 11 talks, but unrelated to them, the Administration, on February 15, determined under section 1377 of the Omnibus Trade and Competitiveness Act of 1988 that Japan had not complied the 1989 agreement to open its cellular systems market to U.S. manufacturers of cellular telephone equipment. The determination resulted from a clear-cut failure of Japan to live up to a commitment to grant U.S. industry "comparable access" to the Japanese cellular systems market under the Third Party Radio and Cellular Agreement. U.S. our efforts to address market access barriers in this sector spanned almost a decade and included two government-to-government agreements and a letter of commitment. While "comparable access" was pledged, the Japanese Government consistently supported actions which impeded such progress.

Following the determination of non-compliance, in accordance with the 1377 process, we began to develop a list of Japanese products on which to levy sanctions equivalent to the lost sales to U.S. industry as a result of the market access barriers. The draft list was to have been published for public comment by March 17. However, on March 12, the U.S. and Japan agreed to a detailed series of actions to be put into place over the next 21 months that will ensure completion of the cellular system and comparable market access for U.S. equipment vendors. The section 1377 process will shortly be formally terminated.

Our experiences in this sector reflect broadly on the frustrations we have encountered in a number of our past bilateral trade experiences with Japan and our determination to pursue results oriented agreements, subject to objective evaluation, under the Framework. We have concluded over 30

trade agreements and initiatives with Japan since 1980, and despite that, as in the cellular telephone sector, we have had to come back to the table again and again, in many instances raising issues in sectors in which we already have an operative agreement.

There are many examples of agreements which have never translated into expected gains in the marketplace. For example, in the glass sector, Japan made commitments in 1992 under the Global Partnership Plan of Action aimed at increasing the foreign share of Japan's consumption of flat glass. In 1991, the foreign share of this market was about 5.1 percent. By the end of 1993, this share had fallen to about 3.5 percent. We also have a 1992 agreement calling for an increase in market access for foreign firms to Japan's 32 billion dollar market for primary paper and paperboard products. In 1991, prior to the agreement, foreign share of this lucrative market was only 3.7 percent. As of 1993, this share held stagnant at about 4 percent. And we also have ongoing concerns as to the way Japan is implementing other agreements, including those covering semiconductors, wood, supercomputers, computers, and amorphous metals, to name a few.

In semiconductors, for example, we remain concerned that U.S. and other foreign semiconductor suppliers are not achieving improved access to the Japanese market on a sustained basis commensurate with their very strong worldwide competitive position. Consultations are under way this week to discuss effective measures needed to ensure that gradual and steady improvement in foreign market access continues through the duration of the Arrangement, as contemplated by the arrangement.

Under the 1992 computer agreement, the Japanese Government committed to expand procurements of competitive foreign computer products and services in Japan. The data we reviewed with the Japanese Government in December of last year showed that while foreign companies made progress in quasi-governmental purchases in Japan, foreign computer companies' share of the Japanese national government market had declined from 4 percent to 3.7 percent. We are particularly concerned with this development given that the national government segment is the largest and only rapidly growing segment of the Japanese computer products market. The thrust of our future efforts to ensure full implementation of this agreement will center on efforts by the Japanese Government to open this important segment of the market.

This need for constant re-negotiation and consultation is one reason why we placed the existing body of trade agreements with Japan in the Implementation basket of the Framework for monitoring and to ensure compliance. And it is the major reason we seek results orientation and the use of objective criteria for the evaluation of success in new agreements arising under the Framework.

As of this date we have not yet resumed discussions under the Framework. However, we are actively monitoring our existing agreements with Japan, and engaging in consultations as called for under these agreements. We are also alert to new areas of possible concern. One such troubling issue, which we are following closely, is the review now underway in Japan concerning the decompilation of computer software. Specifically, the Agency for Cultural Affairs is undertaking a review which could lead to the weakening of copyright protection now granted software in Japan, a development which would seriously harm U.S. interests and put Japan out of step with international practice. The Administration has made it clear to Japan that we would view such a development with the gravest of concern.

We are on new ground in our trade relationship with Japan. We view this as an opportunity to build our overall bilateral relationship by restoring balance and confidence in our economic ties. We would like to see these ties as strong as those which bind our political and security relationships and our ability to cooperate on global issues. We believe that the political leadership in Tokyo shares this view. While we are assessing our options in the trade area, this Administration's approach to Japan will continue to be responsible, deliberate, and conscious of our shared concerns as well as our differences.

The Japanese are also reassessing their position. We understand that the Japanese Government is preparing proposals on a range of unilateral market opening measures to be released late this month, some of which may seek to address Framework issues. We encourage such activity, and support the Japanese Government's steps at deregulation. We would hope to see measures, however, which are bold and aggressive with respect to market access. As the President told Prime Minister Hosokawa, our door remains open to meaningful proposals from the Japanese, but in the end, it is the Japanese market which must be open. We look forward to working closely with Congress as we pursue this goal.

Mr. SPRATT. Thank you, Ms. Barshefsky.
Mr. Tarullo.

## STATEMENT OF DANIEL K. TARULLO, ASSISTANT SECRETARY FOR ECONOMIC AND BUSINESS AFFAIRS, DEPARTMENT OF STATE

Mr. TARULLO. Thank you, Mr. Chairman.

The State Department has responsibility for the economic harmonization basket. That basket has not to date been the subject of much publicity or controversy. I would, of course, be happy to answer any questions you may have about it. But in this oral statement, I will limit myself to a few comments on the overall United States-Japan relationship, to supplement what my colleagues have already said about the framework.

Japan has not yet satisfied the commitments it made in the framework last July. Our refusal to agree at the February summit to less than adequate agreements in the priority sectors, reflected the President's resolve to pursue the economic interests of the United States. It also reflected a new maturity in United States-Japan relations.

For the first time, the United States and Japan refused to paper over differences with vague or nonsubstantive agreements. As President Clinton and Secretary Christopher have emphasized, the absence of agreement on February 11 does not signal a deterioration of the United States-Japan relationship.

The United States and Japan both benefit from a solid security relationship and close coordination on regional political issues such as maintaining peace on the Korean Peninsula and in the Middle East. Our cooperation on global issues continues to be fruitful.

But the events of February 11 did send a clear signal that our past way of working on economic relations is no longer acceptable to the United States, or for that matter, to the rest of the world. When Secretary Christopher was in Tokyo, he clearly stated that Japan needs to take firm action to honor the commitments it made in the framework agreement.

His words did not fall on deaf ears. Japanese editorials during and after his visit have pointed out that "just saying no" to the United States is not enough, and that Japan must take action to reduce its surpluses, open its markets and deregulate.

The onus is on the Japanese Government to propose market-opening initiatives. As Deputy USTR Barshefsky has stated, Prime Minister Hosokawa has indicated his intention to announce a package of deregulatory and market-opening measures at the end of this month. We await those proposals with interest.

Let me conclude by quoting Secretary Christopher in his speech in Tokyo earlier this month. Speaking of the United States-Japan relationship, he said:

> We cannot recognize the full potential of our relationship, unless we have harmony and strength among all its elements. We must make our economic and trade links as mutually beneficial as our political and security bonds.

That, I believe, Mr. Chairman, sums up both the problems with and the potential of our relationship with Japan.

Thank you.

[The prepared statement of Mr. Tarullo follows:]

TESTIMONY OF
ASSISTANT SECRETARY OF STATE
DANIEL K. TARULLO

BEFORE THE SUBCOMMITTEE ON COMMERCE,
CONSUMER, AND MONETARY AFFAIRS
COMMITTEE ON GOVERNMENT OPERATIONS
MARCH 23, 1994
10:00 A.M.

Mr. Chairman, Members of the Committee, I appreciate this opportunity to discuss the status of the US-Japan Economic Framework.

President Clinton and Secretary Christopher have said that the trade and economic interests of Americans must be a priority element of our foreign policy. In no area is this principle more apparent than in the Administration's approach to our relationship with Japan. Though our political and security links continue on a sound footing, our economic dealings are troubled and must be rebalanced. The President made this clear in his February 11 meeting with Prime Minister Hosokawa. Secretary Christopher made this his core message during his recent trip to Japan.

As the President told Prime Minister Hosokawa last month, "no relationship in the world is more important" than that between our two countries. Bound by our treaty alliance, the United States and Japan are an essential source of security and stability in the Pacific. Together we share the common goals of defending democracy and supporting global growth and sustainable development around the world. We cooperate closely on a host of other issues of global importance.

Last July, in his speech to Waseda University, President Clinton called on Japan to join the United States in building a "New Pacific Community" based on "shared strength, shared prosperity and a shared commitment to democratic values."

During that same visit to Tokyo, the President reached an agreement with former Prime Minister Miyazawa on the US-Japan Framework for a New Economic Partnership. In doing so, he took the first step towards placing our economic relationship with Japan on an equal footing with our political and security relationships.

The Framework Agreement was a turning point in our bilateral economic relationship. It reflects the linkages among macroeconomic, structural and sectoral policies. It also reflects the export activism of this Administration, which is directed toward opening foreign markets, not closing our own. This aim is consistent with the interests of Japan, the United States, and the rest of the world. Finally the Framework is explicitly oriented towards measurable results.

In the Framework, the United States and Japan recognized our joint responsibility to promote global growth, open markets, and the global trading system. Both governments made specific commitments to that end. The United States has kept its side of the bargain. We pledged to get our economic house in order and, subsequently, we worked with Congress to pass a major deficit-reduction package. In the 1995 budget, the deficit is predicted to be 40% below earlier projections.

We are also honoring our commitment under the Framework to improve US competitiveness, as evidenced by the President's plans to cut health care costs, encourage technological advances, and improve education and training Our private sector is becoming more productive and competitive. Last year we regained our position as the world's largest exporter. In fact, the growth of US exports as a percentage of GDP now outstrip Japan's. Our firms can obviously compete, when open markets allow them to.

Japan also made commitments in the Framework last July, but they have not yet kept their end of the bargain. Japan explicitly committed to steps intended to achieve a "highly significant" decrease in its current account surplus and a "significant increase in its imports of foreign goods and services." The macroeconomic measures taken by the Government of Japan are not expected to have much effect on Japan's growth rate or on its current account surplus, which stands at over 3% of Japan's Gross Domestic Product. Japan's trade surplus with the United States has grown since the Framework was agreed upon; its surpluses with the European Union and its Asian trading partners have nearly doubled since 1990.

The Framework also called for reaching agreements to open Japan's market in the priority areas of government procurement, the insurance market, and the automotive industries by the time of the first Heads of Government meeting. The agreements were to include "objective criteria" for assessing progress in opening Japan's markets. Unfortunately, Japan was unwilling to agree to a meaningful implementation of this provision of the Framework.

Our refusal to agree to less than adequate agreements in the priority sectors at the February summit reflected the President's resolve to pursue the United States' economic interests. It also reflected a new maturity in US-Japan relations. For the first time, the United States and Japan refused to paper over differences with vague or non-substantive agreements. Instead, we admitted we were unable to agree on some fundamental issues, and vowed to continue working to resolve our differences.

As the President and the Secretary have both emphasized, the absence of agreement on February 11 does not signal a deterioration of the U.S.-Japan relationship. The United States and Japan both benefit from a solid security relationship and close coordination on regional political issues like maintaining peace on the Korean Peninsula and in the Middle East. Indeed, last week while he was delivering an economic message in Tokyo, Secretary Christopher and Defense Department Under Secretary Wisner also met with their Japanese counterparts in the Security Consultative Committee.

Our cooperation on global issues continues to be fruitful. We have resumed discussions under the Common Agenda and are considering expanding them to include possible initiatives on narcotics cooperation, child health programs, and an Asian climate change information network.

But the events of February 11 did send a clear signal that our past way of working on economic relations is no longer acceptable to the United States, or for that matter to the rest of the world. The Administration believes that all nations must cooperate in all aspects of international relations -- including opening their markets.

Japan, which has profited immensely from the post-war liberal trading system, still lags behind other industrialized countries in achieving genuine openness in its markets. Likewise, Japan's macroeconomic policies and surpluses have a greater effect than ever upon the global economy. As many in Japan recognize, that country must change its policies, for its own sake and for the sake of the rest of the world.

The question now is how to move forward in pursuit of our economic objectives. As you know, there have been no discussions under the Framework since the February summit. While Secretary Christopher was in Tokyo, he clearly stated that Japan needs to take firm action to honor the commitments it made in the Framework Agreement.

His words did not fall on deaf ears. Japanese editorials are pointing out that just saying "no" to the United States is not enough, and that Japan must take action to reduce its surplus, open its markets, and deregulate. The onus is on the Japanese government to propose market-opening initiatives. As the President has said, mutual respect also means mutual responsibility.

Prime Minister Hosokawa has indicated his intention to announce a package of deregulation and market-opening steps towards the end of this month. We await his proposals with interest. In the meantime, we are considering our options. Although parts of the press are raising the possibility of a trade war, we neither seek nor expect one. Our policy is one of measured, thoughtful response based on our expectations of Japan and our economic and strategic interests.

During his first year in office, President Clinton has achieved some of the most significant accomplishments on behalf of free trade and global growth in post-war history. He pushed to conclude the Uruguay Round, the largest trade agreement in history. Through a strong personal commitment and against the odds, he won passage of NAFTA. And he demonstrated his commitment to the dynamic Asian economies by hosting the first meeting of leaders of the Asia-Pacific Economic Cooperation forum in Seattle.

Having clearly demonstrated our commitment to liberalized trade and open markets, we will not lessen our resolve in dealing with Japan.

The President's decision to reinstate the Super 301 provision of our trade law provides a valuable tool to supplement our bilateral trade negotiations with all of our trading partners. It is a flexible, orderly way to identify unfair trade practices and eliminate them consistent with the GATT. Its purpose is to open foreign markets, not to close ours.

As we have pointed out to other countries, we seek access to Japan's markets on a most-favored-nation basis. Our negotiations under the Framework are intended to unmanage the Japanese markets that have been managed for decades.

I would like to conclude by quoting the Secretary in his speech before the Kezai Doyukai, the Japan Association of Trade Representatives, on March 11. Speaking of the US-Japan relationship he said, "We cannot recognize the full potential of our relationship unless we have harmony and strength among all its elements. We must make our economic and trade links as mutually beneficial as our political and security bonds." That sums up both the problems with, and the potential of, our relationship with Japan.

Mr. SPRATT. Thank you very much. Let me lead off by asking you to what extent the Japanese Government has the power, other than exhorting entities within its economy, to unmanage its commerce, open up trade? Does it have the power by fiat, by law, by regulation, by influence through regulations like MITI to get to the root of the restrictions that have restricted our access to their markets? Or, are these practices deeply rooted in Japanese culture in their economy like the keiretsu relationships and beyond the reach of government except through exhortation and things of that nature?

Mr. SUMMERS. If I might just take a first crack at that, Mr. Chairman. There is no question that there are deeply rooted practices that would take a long time to change. But most of the things that we are asking for in the framework are things that are directly within the power of the Japanese Government, and where their actions are currently the cause of the problem. An obvious example is the whole macroeconomic area, where it is the government that sets the macroeconomic policies. Another obvious example is the government procurement area, where it is the government that does the procurement.

Mr. SPRATT. Now, I noticed, if I could interrupt you, that you and, I believe, Mr. Garten both mentioned that medical technology fell within the government procurement basket. Is that because most of the government hospitals, most of the medical system is owned or managed or overseen by the government?

Ms. BARSHEFSKY. There is a substantial private medical equipment and technology sector in Japan, about half the market is private; but the other half of the market which is very substantial in size, in the tens of billions, is government controlled.

Mr. SPRATT. Are there explicit restrictions that discourage the purchase of foreign medical technologies?

Ms. BARSHEFSKY. The restrictions are many and are of a type that characterizes much of Japanese Government procurement, generally. There is no advance notice of tenders, which gives an instant advantage to in country and local domestic suppliers. There is often the setting of specifications and standards in such a manner as to discriminate against foreign providers.

The way in which bids are reviewed in Japanese Government procurement tends not to take into account higher technology, higher value added by foreign imports, and instead tends to focus principally on the least cost but also least technologically advanced products, disadvantaging much more competitive foreign industries. So there are a variety of general practices and procedures which tend to pervade government procurement in Japan which also pervade the telecommunication side of procurement, which characterize the medical equipment market as well.

Mr. SPRATT. And so, if the Japanese Government so chose, it could repeal or rescind or modify these rules, regulations, and restrictive laws.

Ms. BARSHEFSKY. Yes. As Under Secretary Summers said, government procurement is an area uniquely within the direct and, indeed, sole control of the government. In this instance, it is the government that is the procurer, the government that announces bids, the government that evaluates bids, the government that selects

the winning bidder, the government that tenders and then selects follow-on bidders. So this is an area not only solely within the government's control, but one as a consequence that it can rectify.

Mr. SPRATT. In that particular basket, or category, are we seeking numerical goals or simply transparency of regulations?

Ms. BARSHEFSKY. We are seeking two things. First of all, process and procedural reform, including transparency and regulation and a variety of deregulatory measures. We are also seeking to capitalize on existing trends in the marketplace in the hope that process and procedural reform will lead to continued market access overall in Japan. But in terms of a specific market share target or market share goal, no, we have never sought any such market share orientation in these agreements.

Mr. SPRATT. Have we even proposed a numerical target or some sort of range in which we would judge whether these transparency measures are genuine?

Ms. BARSHEFSKY. We have proposed a variety, a set, of both qualitative and quantitative criteria which would be used in total to determine whether these agreements are working. On the quantitative side, for example, we are looking at such things as the diminution in sole sourcing of procurements and an increase in the number of foreign entities that are permitted to bid, as well as a look at trends in the marketplace into the future with respect to market access.

On the qualitative side, we are looking at efforts of United States and foreign companies to participate in the market and to come forward with bids and such other details. Our view has always been, and we have expressed this to the Japanese Government quite consistently over the past 9 months that one does not want to choose any one factor as determinative of whether an agreement is working or not.

Markets are very complicated things and there are a number of factors that can influence foreign participation in a market. But we have proposed a set, and in the case of these agreements, perhaps, 8, 9, or 10 factors to look at in the aggregate as a means of determining overall whether market access objectives are being achieved.

Mr. SPRATT. All right. Given that kind of flexibility, why did the talks in this particular sector, or basket, break down? Why was that not workable?

Ms. BARSHEFSKY. The talks broke down for a number of reasons. First of all, we had not achieved full agreement on a variety of process and procedural issues, some of which are controversial from the Japanese point of view but are practiced by a number of other governments.

Second of all, the Japanese Government would not accept as a goal the very goal articulated in the framework itself, which is "A substantial increase in market access and sales of competitive foreign goods and services." That's a quote from the framework. The Japanese Government's position was, "Well, that may be in the framework, but that is not an appropriate goal for individual agreements negotiated under the framework." That was obviously an untenable position and an unacceptable position from the point of view of the United States.

And, last, the talks broke down because there was no agreement on the qualitative and quantitative factors that should be utilized in assessing progress toward market access. The Japanese Government's view of these indicators was to put forward, in essence, data points unrelated to what was happening in the marketplace.

So, for example, a chief qualitative indicator for the Japanese Government was the number of seminars held in Japan on government procurement issues. That has limited relevance with respect to market access in Japan, whereas factors that we put forward such as the diminution in sole sourcing were much more pointed and much more designed to get at change in market behavior in Japan.

Mr. SPRATT. Mr. Summers, I believe you are responsible for financial institution securities, insurance, banking. And, in that particular case, those are all highly regulated enterprises in any country, specifically and particularly in Japan. How do the Japanese defend their regulations that have restricted the insurance market such that American insurance firms can only penetrate 3 to 4 percent of it? Does it have to do with the capitalization of our firms?

Mr. SUMMERS. I think that in places around the world where deregulation is being discussed there is a standard set of arguments that those who want to maintain regulation make: That it's necessary to protect the consumers; that it's necessary for stability; that it is appropriate in order to avoid change that is too rapid; that in the financial area, it is necessary to avoid the possibility of fly-by-night operations. I think those are the kinds of rationales that are offered.

Frankly, with respect to the kinds of requests that we are pursuing, I don't think those rationales are persuasive at all. I think that they are a fairly standard set of excuses of a kind that is made in any country before there is deregulation. I think it is very important to understand with respect to most of these regulatory issues in the framework that this is like some of the kinds of deregulation we have had in this country.

Yes, it's in the interest of foreign producers for there to be deregulation, but it is overwhelmingly in the interest of Japanese consumers for there to be deregulation. For example, so they can get better access to insurance products.

Ms. BARSHEFSKY. Mr. Chairman, if I may add to that response, there are four principal roadblocks to foreign market access in the Japanese insurance sector. The first is a nontransparent regulatory regime based largely on the use of administrative guidance; second, a highly concentrated industry structure in Japan; third, a variety of keiretsu and cross-shareholding arrangements; and, fourth, a highly restricted insurance product approval process and a noncompetitive pricing process in Japan.

The agreement that we put forward in the insurance sector attempted to address each of these process and procedural irregularities in such a manner as to provide enhanced competitive opportunities for foreign insurance providers.

Mr. SPRATT. Mr. Garten, you are in charge of international trade administration. There are those critics who say that we look at this too narrowly. There was an op ed piece in the Wall Street Journal yesterday by, I believe, a Japanese who works for McKenzie, and

others have said that our view of what the current account is or what the trade deficit is, is much too restrictive.

For example, we should consider the fact that American firms in the 1950's and 1960's located in Japan have a substantial sales volume that is generated in Japan itself: IBM, Coca-Cola, and Xerox. That should be taken into account.

There are also sales that don't appear in the "International Book of Accounts" because they don't actually cross the Japanese border. For example, Lorale sold a satellite to Japan that will be launched in a couple of years. Since it won't actually be delivered to Japan, apparently that export worth $400 million to $500 million won't actually be booked as an export to Japan. It will be booked as an export to wherever the launch takes place.

Thank you very much, Mr. Summers. We appreciate your coming.

Does the Commerce Department have a different means of calculating the trade account with Japan that mitigates the deficit somewhat and gives us a more benign view of the nature of it, or would you subscribe to that point of view?

Mr. GARTEN. Well, I think there are so many different ways to look at the sum total of the economic and commercial interaction between the United States and Japan that we could get very confused in trying to compare one methodology with another or one set of accounts with another.

I think by any measurement the interaction between the two economies is very, very deep, and it has certainly become deeper over the years. We are trying, of course, to upgrade our ability to track these interactions. For example, in the Commerce Department we are now tracking services so that we can present the balance of payments in a much more comprehensive way, not just goods but services. Services are a very competitive part of our economy and we're running substantial surpluses.

I think the point is that we are not using "we" as an administration, the bilateral trade balance as the indicator here or as the imbalance that is the goal of the framework agreement. Of course, we look at it and of course in particular sectors it has great resonance. But, when all is said and done, it is a multilateral trading system and it is very, very hard for us to track everything. I think it would be a major mistake for us to look just at the bilateral interaction for a lot of the reasons that you mentioned, that it is only one of many, many indications of how we are doing.

If you look at Japan's global trade investment situation, what you see is really indisputable. The only significant surplus of all the industrialized countries, a country that runs chronic large surpluses, which is another way of saying that basically they are taking from the world economy much more than they are giving.

I tend to see these surpluses as a deflationary drag on the rest of the system. Were those surpluses not present, it's reasonable to think there would be more job creation outside of Japan. It is just that Japan is so out of step with the other industrialized countries and has so much scope now, really, to reduce these surpluses by macroeconomic measures such as faster growth in Japan that that is what really underlies our approach.

I think that it would really be a mistake to look at any one indicator and say that this balance or that balance is the only measure for what we are doing. In any event, in the framework we are balancing macroeconomic issues with sectoral issues.

No matter what the macroeconomic situation is it would be very hard to explain to the automobile industry, the auto parts industry, the medical technology industry, or any of these that the global picture is relevant to them when they see that there are very specific, very concrete barriers to their being able to enter the Japanese market, while Japanese firms have no such barriers here.

Mr. SPRATT. Thank you very much.

Mr. COX.

Mr. COX. Thank you, Mr. Chairman. I'm not certain because of the nature of the questions I'm going to ask which of you would most like to answer them, so why don't I address my questions to the panel and anyone who would like to respond first, please do so.

I would like to start by asking your view on a Congressional Research Service memorandum that was prepared for the House Government Operations Committee in anticipation of this hearing. The memorandum is prepared by the specialists in international trade and finance at CRS.

I hope this is not a journal vote. It appears that it is. Do you want to go and come back?

Mr. SPRATT. Why don't you go ahead and ask some questions and Chris can go and you can go later.

Mr. COX. OK, thanks.

The memorandum before me says:

> Clinton Administration trade policy toward Japan is based on the position that previous trade agreements have failed to produce acceptable results, and that therefore the Clinton Administration is now insisting that the notion of results-oriented negotiations must be a provision of the United States-Japan framework concluded in July 1993. A CRS report for Congress concluded, however, that U.S. exports of products that were the object of U.S. trade agreements with Japan increased faster than other exports to Japan and United States exports to the world as a whole.

Can any of you respond to that any of you?

Mr. GARTEN. I think we would all like to say something. I think that the areas that we have focused on in terms of negotiations with Japan tend to be those where the barriers are so egregious that any movement in those areas produces some additional exports.

If you want to measure the growth of exports, you are measuring it most of the time from a dead stop, so that what you could say is that exports of a certain product increased rather rapidly. But it started from a base where we weren't there at all, and we tend to pick those areas where we have the strongest complaints and where we feel that we are the most competitive.

I don't deny that in some areas you can show export growth. But I think the more fundamental question is: From what base? And also, how do you compare that growth with the growth of trade in that sector, from the American standpoint, globally?

You go back to something like medical equipment where it was so competitive and where our position in Japan is clearly out of proportion to where it should be. Any breakthrough would probably show some significant growth because we are so competitive. I don't want to discount the analysis because I haven't seen it or

read it, but I don't think it undercuts the notion that we have so many different areas where we feel blocked and there are so many parts of the Japanese system that we believe needs to be deregulated and opened up.

Incidently, we say this, but so do the Japanese, so does the Hosokawa administration. And if you look at the statements of all of the top people, they have said the same thing. We are not arguing, I think, about the objective situation. What we are arguing about is the means and our insistence that we be able to track the results.

Mr. TARULLO. Congressman, if I could, I haven't seen the report, either. But I would note that in many of the areas, as Under Secretary Garten stated, with which we have been concerned in trade agreements, the initial level of sales by United States firms into Japan is extraordinarily low.

Thus, for example, if U.S. companies are selling a hundred units of a product into Japan, something that constitutes 0.1 percent of the market, and in the wake of a trade agreement they are selling 200 units in Japan, you can look at it two ways. One, you can say it has been a 100-percent increase in exports, and the other you can say that any increase in exports that has taken place has been trivial.

Without having seen the report, without having seen the specific figures that are adduced there, I think this technical point I've made is just an important one to keep in mind in assessing the progress of agreements in general.

Mr. GARTEN. Let me just add one thought here which comes to mind from personal experience. In the late 1980's I lived in Tokyo and I was in charge of a major American investment bank. We started with two people, and we worked very hard to break into the market. After about a year, the firm was absolutely ecstatic and couldn't understand why the U.S. Government was making such a big deal out of financial services since we had doubled, tripled our profits.

We started with nothing. And at the end of that year relative to the firm or to the industry it was insignificant, but we were making a lot of noise, both through our Washington representatives and everything else, that this market was open. But we were looking at it very, very parochially and looking at it from a baseline which was zero to start.

Ms. BARSHEFSKY. If I may add one point, I think we also need to look at the macroeconomic dimensions of the problem. If we look at imports as a percent of GDP, imports as a percent of GDP in Japan is about 3.1 percent. In the G–7, excluding Japan, it's over 7 percent. That is, Japan imports as a percent of GDP less than half of what the G–6 countries import in manufactured goods.

Mr. COX. I wonder if I could ask you a question on that point. Do Americans buy more per capita from Japan, or do Japanese buy more per capita from America?

Ms. BARSHEFSKY. I'm not sure I know the answer to that. The reason that I raise the GDP——

Mr. COX. What I have before me says that as of today Americans buy less per capita from Japan than Japan buys per capita from America.

Ms. BARSHEFSKY. I don't know. I mean, I'm not familiar with the statistics on that.

Mr. COX. That would tend to undo the point you just made, I think.

Ms. BARSHEFSKY. Well, I don't think so. If we look at the ratio of imports of manufactured goods to GDP, we see that in Japan that ratio has not changed in over 20 years. In the rest of the major industrialized countries, the ratio has more than doubled.

Mr. COX. I think we are straying awfully far from the question that I put which is that in those areas which were the object of U.S. trade negotiations with Japan—if it is indeed true, as I take it everyone agrees it is—that relative to what was going on across the border in Japan the United States' improvement was better there than elsewhere. Weren't we doing something right in the negotiations?

Mr. GARTEN. Well, there are also examples——

Mr. COX. I mean, if it was stipulated it was zero and that it improved and that we may overstate if we use a percentage measure of the magnitude of the improvement, nonetheless if it improved, weren't we doing something right in the negotiations?

Mr. GARTEN. If you look at the amount of effort that the American Government has made since the 1960's to open the Japanese market, it would be hard to conclude that all of that pressure resulted in nothing. And so I think that the very fact of the pressure and the focus on Japan has been a good thing.

We are now at a stage with our economic relationships where we need much more progress than existed and has been reflected in the past. Our focus on trade as a central part of our overall economic strategy and as a way to generate jobs in the United States compels us not to say that what has happened in the past has been enough, or anywhere near enough especially in light of these enormous surpluses in Japan and the very, very slow progress in terms of stimulus, deregulation, and the opening up of key sectors that are in the framework.

I think that without denigrating past efforts, and we can argue about whether it was enough or whether it was effective, it is clearly not enough for us looking ahead, and it's clearly not enough in the sectors that we have focused on in the framework.

These areas of government procurement which are very much in the control of Japan and where we are focusing on those sectors of our economy that are clearly very, very competitive: telecommunications, medical equipment, and in the automotive area where the American companies have been making very significant efforts to improve their competitiveness and where they ought to be able to look forward to in the future some share of the Japanese market that is not token or minuscule.

Mr. COX. I think my own approach to this, and I hope it's shared by some here, is not liberal or conservative, not fair trade or free trade or protectionist, but rather on the notion and the premise that we can probably all agree that it is mutually advantageous to expand trade between Japan and the United States. I would call it empiricist; that is, we ought to do what works. I think the question before us right now is: Is the Clinton administration's ap-

proach to these talks, from an empirical standpoint, working; and is it the approach that is most likely to work?

On that point, I know very well from reading the newspapers and listening to your testimony and the background that was provided by our staff here of the sticks that we are offering in the negotiation. What are the carrots, good negotiating strategy comprising carrots and sticks? What are the carrots for Japan? What are we offering if they come our way?

Mr. GARTEN. Well, I think we have given them a tremendous amount. I mean, we have an open market and we have——

Mr. COX. Let met put it rather specifically. In the context of a negotiation, what are we proposing to change that would be a carrot?

Mr. GARTEN. Well, I'm not sure that—it is incumbent on them to change, not us. We are the ones with the open markets.

Mr. COX. Is it fair to say that we are offering no carrots in the way of changing the status quo here in America?

Ms. BARSHEFSKY. If I may respond. If we look at government procurement in the framework, it is a specific Japanese Government commitment to substantially increase government procurement in a variety of sectors.

Mr. COX. Well, on that point, are we offering in any way to have our U.S. Government start buying things from Japan?

Ms. BARSHEFSKY. Well, let me finish.

Mr. COX. I wouldn't think so. It would never fly here in Congress.

Ms. BARSHEFSKY. On the U.S. side, we have agreed to consult with Japan with respect to areas of concern. There are areas that the Japanese have brought to our attention that are of concern, among which are our "Buy America" policies. And we have provided them with information on "Buy America," the precise manner in which it operates, and our view that the "Buy America" provisions do not unduly discriminate against Japanese producers.

Mr. COX. In the sense that they discriminate against all producers who are un-American, right?

Ms. BARSHEFSKY. In the sense that our "Buy America" provisions are transparent, unlike buy national provisions of most other countries in the world, and the fact that the price preference under "Buy America" tends to be small and is also transparent and the fact that government procurement covered by the government procurement code, which is on the Federal Government side over 70 percent of all procurements, are not subject to "Buy America" at all. That is substantially more liberal a procurement regime than in most other major economies in the world.

Mr. COX. By the way, I agree with that.

Ms. BARSHEFSKY. So we have provided the Japanese with that information, and have indicated that to the extent we can work with them to further their understanding of the system, we are delighted to do that. With respect to the insurance sector——

Mr. COX. By the way, that is a good argument why we may feel very comfortable proposing no change in our position on that point.

Ms. BARSHEFSKY. Yes.

Mr. COX. My question goes to whether we are proposing any change in any position as a carrot, or whether the negotiating strategy is entirely one of a stick or sticks.

Ms. BARSHEFSKY. No, not at all. With respect to insurance, the Japanese have indicated that they have concern about the fact that insurance is State regulated, not Federal regulated, and therefore regulations differ from State to State.

Of course, we have indicated to them that the system is as it is, but that we would be pleased to work with them in the context of individual States and in the context of the overall insurance association that tends to govern State regulation, so that those regulations would be apparent to them.

I should note, in the insurance sector foreign import penetration into the United States is 10 percent; it is 2 percent in Japan, suggesting that State regulation of insurance is not any particular barrier to the provision of insurance by foreign insurance providers in the United States.

But we have indicated that we would be pleased to work with them and with State insurance commissioners hand in hand to ensure that Japanese companies were in no way disadvantaged by State regulation.

Mr. TARULLO. Congressman, if I may——

Mr. COX. We've got a vote on and I apologize.

Mr. TARULLO. Oh, I'm sorry.

Mr. COX. I think I'm going to be able to get in one more question, and I'm going to have to run across the street.

In international relations, trade being a part of that overall genre, clarity is vitally important because of cultural differences, language differences, and the many opportunities for misunderstanding that abound. We have seen in our relationship with Japan that that's especially likely. Therefore, clarity would be a hallmark, it strikes me, of a potentially successful negotiating strategy.

I have listened over the weeks and have listened again today to the fine distinctions between specific targets and quantitative measurement. I have to say that it leaves me confused. Today, Ms. Barshefsky, you stated, I think I'm repeating approximately what you said, that we have proposed no specific targets. And at a later point in your testimony you said that one of the reasons the agreements—the talks have broken down is that there is no agreement on quantitative measurement.

Aren't we guilty of what the medieval monks did when they were all worried about how many angels could dance on the head of a pin? This is a rather fine point; isn't it? I mean, we're talking about quantitative measurement of market share; aren't we?

Ms. BARSHEFSKY. No, we're not at all. Let me make a couple of comments. First of all, these issues become very concrete in the context of individual agreements. Obviously, we are limited in what we can say publicly because this is the subject of government-to-government negotiation, and all we do in public discourse in detail on a sectoral basis is potentially to compromise our negotiating position. And so as a general matter, I would certainly offer to come in and talk to you about this in more detail.

But, second of all, if you think about the issue of targets, the question really is a compliance issue. What is it that will assess

compliance with an agreement or not? In the case of a target, compliance is assessed on the basis of that target. Did you hit 5 percent, or did you hit 10 percent? Or, did sole sourcing of procurements go down? That is the essence of your assessment of compliance.

With respect to the qualitative and quantitative criteria that we have proposed, we are proposing in these agreements 7 or 8 or 10 different factors one would look at in assessing compliance. These would be looked at in the aggregate, in the overall, to see if there is a substantial progress toward market access.

So the compliance exercise is a much more broad one, taking into account such things, for example, as U.S. company efforts and foreign company efforts to penetrate the Japanese market. We are not looking for any single factor to dominate that analysis. We are looking instead for a critical mass of progress with respect to market access in Japan.

Mr. COX. I'll just conclude with one material point, I think, in the United States-Japan financial relationship, and that is, our differing positions as foreign borrowers. The United States unlike Japan is a large net foreign borrower, and I want to ask a question to restate the obvious. Our trade deficit does not include Japanese purchases of United States debt; isn't that right?

Mr. GARTEN. That's correct.

Mr. COX. He agrees with that. What would happen if Japan stopped buying United States debt, if they just stopped showing up at our bond auctions?

Mr. GARTEN. Well, I wish Mr. Summers were here to answer that, because he could give you a much better answer. Of course, this was something that had been raised in the eighties, in the late eighties when Japan held such a significant proportion of United States debt. That proportion is way down now, and I don't believe that this is something that the Japanese——

Mr. COX. In fact, I understood the other day that Taiwan is the No. 1 holder of United States debt.

Mr. GARTEN. It could be. I don't believe that this kind of thing is something that is seriously considered in financial circles if a lot of Japanese borrowers hold American debt and they begin to sell it, and I think the implication of what you're saying is sell it as a form of punishment, they would all lose. They would drive down the value of the debt to such a point where their own portfolios would be really undermined. So I don't think this is really an issue that——

Mr. COX. I raise the point only to illustrate another area of our interdependency. We have a lot to gain from continued good relations with Japan and expanded relations with Japan. I want to keep the focus as we evaluate our negotiating strategy on the likelihood of success and what will work. Prime Minister Hosokawa is committed to political reform. Things are different. There is no more Soviet Union. Japan is no longer dependent upon us, from a security standpoint, as they used to be.

When I hear that—at least I have heard no specific carrots described here, that our policy is based entirely on sticks, I get concerned that we are possibly as a negotiating tactic ill-designed pushing our negotiating partners into a corner where for domestic

consumption they can be anti-American and it works and we have developed our own position into one of greater weakness.

I yield back to the chairman.

Mr. TARULLO. Congressman.

Mr. COX. I've got to go vote.

Mr. TARULLO. Congressman, if I could just say——

Mr. COX. Please respond for the record. I'll read it but I've got to go vote.

Mr. TARULLO. OK. That's fine.

Mr. COX. Thank you very much. I'll be back.

Ms. MARGOLIES-MEZVINSKY [presiding]. I want to shift gears a bit to ask a question to Ms. Barshefsky, a question that I think is very important to this committee and to other members in Congress. Do you know what this [indicating] is? This is a telex which was moved from Secretary of State to Caracas in the middle of the night last week. I'm going to give you a copy of it.

I'll explain what it says. It offers Pedevasa, which is the Venezuelan oil company, a compromise on a modified baseline that EPA rejected in its rulemaking in December. It is very hard to read. A compromise that clearly violates an understanding that I and quite a few other Members of Congress had with the EPA, the State Department, and the Office of Trade. Are you familiar with this telex?

Ms. BARSHEFSKY. I'm not at all familiar with the telex, no. And you're right, it's very hard to read. I'm familiar somewhat with the issue, at least in the broadest sense.

Ms. MARGOLIES-MEZVINSKY. But you don't know that this telex was sent?

Ms. BARSHEFSKY. No. I mean, no.

Ms. MARGOLIES-MEZVINSKY. And do you know about the compromise?

Ms. BARSHEFSKY. May I say that we have had conversations with the Venezuelans which have raised a serious question whether the rules as currently written violate U.S. GATT obligations. And so to the extent that the Venezuelans have raised this as an issue, I am certainly familiar with that. I am also familiar with the fact that the U.S. Government is in the process of looking at this GATT question, whether there is a potential violation there.

Ms. MARGOLIES-MEZVINSKY. What we understand is it was sent, and it is a fait accompli. The compromise has been reached. It is a done deal from what we were told. You're not aware that the Secretary of State sent this down to Caracas?

Ms. BARSHEFSKY. No, no, I am not aware of that. What I can tell you in terms of what I know is that to the extent there would be, or need to be if there is a GATT-related issue, a change in U.S. rules, that would presumably have to be done by a notice of proposed rulemaking. There can be no "done deal" in the context of a notice of proposed rulemaking.

Ms. MARGOLIES-MEZVINSKY. Well, let me share what has happened with us this week now that I have you here. There has been from what we understand a compromise, done deal. It is basically promulgated by us. And what it does is it compromises regulations that were set forth by EPA that I and a lot of other people fought

for. This telex essentially went behind our backs. It compromises the work of this committee and many Members of Congress.

What in the world is going on? Why do we have hearings? What about the rules? What about the regulations? All week long I have been on the phone and members of my staff have been on the phone and other members. I mean, it was easier, frankly, for the Venezuelan Government to get information from the State Department, the EPA, and Trade than it was for us. We had no idea that this was sent—none. This is a disgrace.

We are very, very surprised by this. You know, what's going on? I mean, when the rules and regulations of committees that we put into action can just be waived in this manner, we are really surprised. Every time we pick up the phone we are getting more information that doesn't work for us.

Ms. BARSHEFSKY. If I can respond. I do not understand that the United States has waived any rules or regulations. It is my understanding that if there is to be any change in the position with respect to Venezuela, there would have to be a proposed rulemaking published, open for public comment. In that context, there is no "done deal," as in an administrative law context there could not be.

Ms. MARGOLIES-MEZVINSKY. They have offered a compromise to Venezuela—that's in the telex—that would, in effect, waive those rules.

Ms. BARSHEFSKY. The only comment I can make at this point is to say that perhaps your questions are best directed at EPA. I just don't know.

Ms. MARGOLIES-MEZVINSKY. No, but were you negotiating last week for a compromise?

Ms. BARSHEFSKY. No, I have not been a negotiator on this issue at all.

Ms. MARGOLIES-MEZVINSKY. OK. What I would like very much is if somehow our offices could get together on this and figure this out.

Ms. BARSHEFSKY. Sure.

Ms. MARGOLIES-MEZVINSKY. Because this came as more than a surprise to us. I would put it in the category of a shock and a disappointment. Somehow we have got to figure out what is going on, and we have got to make sure that the rules and regulations that we put into effect are protected.

Thank you.

Mr. SPRATT [presiding]. Are you still in process of asking a round of questions?

Ms. MARGOLIES-MEZVINSKY. No, you can take it.

Mr. SPRATT. OK. Mr. Shays.

Mr. SHAYS. I would like to thank you all for being here. I consider this issue extraordinarily important. For the most part, I have a very favorable feeling about what the administration has been doing on this issue. Maybe it's that I am not informed enough. I have a number of my colleagues and the people I respect back home who are concerned that we are confronting the Japanese in a way that embarrasses them and will cause them to react negatively. But as I try to sort out this issue, I just think it is long overdue.

I guess what I want to do first—I want to clarify a few points to start. Is it the administration's position that we have to have an equal balance of trade?

Mr. TARULLO. Absolutely not, Congressman.

Mr. SHAYS. With any country?

Mr. TARULLO. Absolutely.

Mr. SHAYS. There are some in Congress that advocate that if Japan is over they have to have an equal balance of trade, and yet we have unequal balances of trade in our favor with other countries. It seems to me it would be tremendously hypocritical to make that kind of argument because then other countries will make it to us. So there is no sense in the administration that this is our objective? Our objective is, as I've heard it, to open up markets where they are closed?

Mr. TARULLO. That's correct.

Mr. SHAYS. Our objective as I hear it is that when the Japanese agree to something they keep their word?

Mr. TARULLO. That's correct.

Ms. BARSHEFSKY. Yes.

Mr. SHAYS. Where do you feel the Japanese have been the least faithful to their word in agreements with the United States?

Ms. BARSHEFSKY. If I may rephrase the question, because I don't think I want to respond to it in quite the way you have just said it. We believe as we look at the body of agreements negotiated with Japan——

Mr. SHAYS. Where do we have the most work?

Ms. BARSHEFSKY. There are a number of areas where prior agreements did not achieve results in the marketplace. Let me give you a few examples. If we look at the glass agreement, it's an agreement over 2 years old. Foreign penetration into Japan's glass market is 50 percent less now than what it was before the agreement was signed.

If we look at the paper agreement, which is an agreement almost 3 years old, we see that foreign import penetration into Japan has been stagnant.

If we look at the computer agreement, we see that while foreign computer companies have made gains in one sector of Japan's computer market, the quasi-governmental entity sector, which is the slowest growing sector, foreign market share has decreased in the rapidly growing and important segment of the Japanese computer market, which is central government procurement of computers. So there are a variety of areas where we have agreements but have seen little progress.

Mr. SHAYS. Let me take glass, paper, and computers. Your last point with computers is that in the private sector in Japan we are doing well, and within the government purchasing of the government for the government, you have seen a decrease in market share?

Ms. BARSHEFSKY. In not so much private sector, but in what is called quasi-governmental which was joint venture.

Mr. SHAYS. OK.

Ms. BARSHEFSKY. But in the central government procurement sector, we are not doing well.

Mr. SHAYS. How can you determine, and what formulas do you use to determine whether that is their fault or our fault? I mean, when I look at the automobile industry, I don't think it's their fault if we don't design a car that fits in their parking spaces and has the steering wheel on the same side, and so on—I mean, I realize there are other factors—maybe we haven't had an aggressive campaign to market. So what is the criteria that you use? By the way, I open this to anyone.

Ms. BARSHEFSKY. One of the reasons we have proposed a variety of criteria is precisely to get at what you are asking, which is to be sure where the problem is. Is the problem the United States? Is the problem a foreign competitor? Is the problem in Japan?

With respect to glass, paper, and computers, we know that in the glass and paper sectors United States and foreign industries have been extremely aggressive in trying to sell into Japan. We also know with respect to glass and paper Japan's own Fair Trade Commission has said that those markets are characterized by oligopolistic practices, but the Japanese Government has taken no antitrust action against those producers.

We know in the case of computers that the U.S. computer industry is the world competitor but is not able to sell in any significant quantity to the Japanese central government. So in these areas in particular, we know we have highly competitive producers who have made the requisite efforts but who are stymied in their efforts in sales to Japan.

But I think the question you are asking is a legitimate one because I think that there are potentially other sectors where the case is not so clear, and it is not clear whether it is the foreign producer's fault or the fault of the Japanese Government with respect to limited access. Those situations need to be looked at very carefully.

Mr. SHAYS. When I was first elected in 1987, I served on the Government Operations Committee and there was a hearing at which there was a complaint by seven computer companies that IBM had too much of a market share of government contracts. It was fascinating for me because we determined the seven companies were basically American names but Japanese owned or Japanese products.

I was interested, one, that they had such tremendous clout in this country to come before Congress to make a complaint against IBM. And by the way, what we determined in the committee was that IBM had a greater market share of these particular products in the private sector than they did in the government sector, and contrary to what these seven companies had claimed, IBM deserved a greater share, rather than less.

That is not to say that we didn't uncover some practices at IBM that we didn't like, relationships with salesmen to government employees that were very troubling. But would we have the same access to bring a complaint before the Government of Japan? We, the government, would IBM, have that same ability?

Ms. BARSHEFSKY. No.

Mr. SHAYS. No.

Ms. BARSHEFSKY. No. We have in the supercomputer agreement and in the computer agreement negotiated for a form of appeals process within the Japanese bureaucracy.

Mr. SHAYS. But you had to negotiate it for that particular product?

Ms. BARSHEFSKY. Yes. There is no equivalent to our GSA. There is no equivalent on procurement to our Federal court system.

Mr. SHAYS. So not only through GSA, the court system but—excuse me, GSA and the government system through there. They have greater access to our courts than we do their courts on these issues?

Ms. BARSHEFSKY. In the case of procurement, yes, there is no question.

Mr. SHAYS. Let me just cover two other areas. One of the things that troubles me in this area is that you can have the camel's head under the tent and you can have had a victory, but how do you know where to stop? How do you know when you have given the right message and stood up to where you need to stand up? But having gone so far, how do you decide that?

Mr. GARTEN. Well, let me start. This is not a problem that we face, because we don't feel we are anywhere close.

Mr. SHAYS. OK. I can accept that.

Mr. GARTEN. So I think where we stop, and I think that's a long way into the future, is when we feel, and I think this is something we would work out with the Japanese Government, that they are basically as open on balance as other major industrialized countries which as a group is taking responsibility for some sound management of the world economy.

We believe that they are not doing their share, and that it's not even close. You know, even they say that. Even the Japanese leadership, if you can divorce it from specific means, they all agree that the biggest challenge facing them is to open up to the world economy in the way that other major industrialized countries can. When it even got close to that, I think we would have a much more normal trade relationship with them, and the kinds of frictions that we face wouldn't be present.

But if the current trends continue, and I don't mean just this year but if you go back over the last decade, this is a long-term effort on the part of us and the Japanese Government to work toward more openness. When is enough, enough really does not arise as an operational problem, much as we would love to be in that position.

Mr. SHAYS. I am a former Peace Corps volunteer, and we were taught to recognize other cultures and habits, because what we would say overseas to someone could have a totally different meaning. So I have some concern, and yet I feel like it's being used as an excuse. In other words, that we might embarrass the Japanese Government and they may feel, therefore, that they have to respond in a way that we might think is illogical in our way of thinking and our culture.

I guess I would just like for you to address how you wrestle with wanting to get the results that you want, wanting to use your common sense American way of just saying, you know, "a deal is a deal," and "this is it" and "face up to it or face the consequences"?

How do you wrestle with that kind of issue? Do you totally ignore it, or how does it fit in?

Mr. GARTEN. Well, I think that President Clinton set a really very appropriate tone at the end of the February 11 summit, which was a tone of great respect for the Prime Minister and the efforts that he was making, attempting to make in deregulation and which acknowledged that no bilateral relationship is more important to us than Japan and in underlining the fact that our relationships remain strong.

There is no attempt at all on the part of the administration to embarrass the Japanese. At least insofar as my experience in the administration is concerned, the negotiations are conducted with great mutual respect. We have gone to great lengths to listen to not just their goals but the kinds of problems that they present in terms of implementation.

I think all of this talk about embarrassment or backing into a corner is really misplaced. We have really conducted this in the most low-key professional way. We have recognized and they have recognized that we have a very significant problem that we are trying to address in our interest, in their interest, and in the interest of a lot of other countries.

Now, I don't think that there has been any—there has been certainly no attempt to embarrass them. And I would tend to think that anyone who says that they are embarrassed is really misreading the situation between two very mature countries that have a lot of responsibility for managing these economic relations.

Mr. SHAYS. I feel you have kind of answered the question, but maybe I'm asking an impossible question. Do we in our negotiations, not just with Japan but other countries, take into consideration their way of doing things and try to deal with it on their level, or do we just totally ignore it?

Mr. TARULLO. Congressman, I think in any negotiation, whether it's government to government, management to labor, House to Senate, any form in which negotiations take place, one has to take into account the position occupied by one's negotiating partner. One has to understand the circumstances occupied by that partner. I think we try to do that in our negotiations on all subjects with all countries. That can't, however, detract from the necessity of our stating forthrightly what our interests are and what we need in any particular case.

Mr. SHAYS. I will just conclude by making the comment, so long as the administration takes the approach that markets need to be opened, uses the powers that we have to do that and is conscious of where the fault really lies and is up front about it—sometimes it is our fault, sometimes it is their's—and so long as we don't buy into the argument of some Members of Congress that somehow we have to have equal trade, which blows my mind, I would like to think that someday maybe it will be unequal in our favor. I strongly endorse and am very comfortable with what I have wanted my government to do for decades.

Thank you, Mr. Chairman.

Mr. SPRATT. Thank you, Mr. Shays.

Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman. I apologize for us having to run back and forth. That's just the nature, I guess. The problem we have is overall, it's not just Motorola. I will submit my statement for the record.

[The prepared statement of Mr. Green follows:]

**Statement of Representative Gene Green**
**Government Operations Subcommittee on**
**Commerce, Consumer, and Monetary Affairs**
**March 23, 1994**

Thank you, Mr. Chairman. I believe that two competing beliefs are at the root of our present disagreement with Japan over the Framework talks. The first--which is the Administration's position--is that Japan's domestic economic structure is sufficiently unique, and our negotiating record sufficiently ineffective in opening their markets, that non-traditional methods are required to open it. This leads us to a results-oriented approach.

The other, held by many Americans and the Japanese government in their public pronouncements, is that Japanese companies are generally independent of their government and not

much influenced by governmental encouragement to buy imports. In short, they are private companies making private decisions.

I would like today's panels in their opening remarks to comment why they believe Japan is or is not unique in its domestic economic structure; why macroeconomic tools such as the exchange rate or fiscal stimulus are or are not effective in increasing Japanese imports. In short, how do you describe the causes of the U.S.-Japan trade problem? I look forward to the panels' responses and will ask more specific questions later in the hearing.

Thank you, Mr. Chairman.

Mr. GREEN. It's a $59 billion problem on an annual basis. Seeing all the logos on the cameras today, Mr. Chairman, if we have more of these hearings, I think we will see that balance of payments decrease just a little bit if we have a few more of these hearings.

Let me ask a couple of questions. One, and I know it was addressed earlier in Mr. Summers' testimony and maybe even into the questions. It seems like our government's concern or goal is the objective indicators, whereas Japan continually says that we are asking for numerical targets. It seems like we have lost the public relations battle a little bit on that.

How can we somehow explain that we are talking about an objective and not necessarily a numerical target, so many cellular phones or so many auto parts or whatever? And that's one of the—at least in the last few weeks it seems like the response is, and it seems like we've got less—at least from publicitywise, you know, the numerical question came up more often.

Mr. TARULLO. Congressman, I think you are correct. I think one of the reasons for that is, that despite some earlier inaccurate information which was circulated somewhat widely, that our emphasis from the outset has been on achieving results and opening markets. That's what is important. We are trying to unmanage trade.

As Ambassador Barshefsky and Under Secretary Garten and Larry Summers when he was here all have emphasized, we have asked for and the Japanese have agreed to the use of objective criteria in order to measure progress toward that goal of opening markets of market access.

I think everybody's attention in the United States and Japan and the rest of the world needs to be focused on that ultimate goal. I believe that since the President's press conference following the summit in particular, that message has been conveyed effectively, and the people understand what our goal is.

Mr. GREEN. OK. I guess what we have learned from the Motorola experience is, if we are really serious about it, the only thing we can do is threaten with Super 301. I mean, it seems like that negotiation—and you were right in your response to Mr. Shays. Whether you are negotiating within Members of Congress or the House or the Senate or with the Governments of the United States and Japan, you know, that was the ultimate threat to say, "OK, we can close our markets unless we see something."

Are we going to have to do that on every example, whether it be telecommunications or, again, auto parts or anything else? Is that going to be what our trade representatives are going to have to do?

Ms. BARSHEFSKY. We would certainly not prefer that as an option, but there is something of a historical cast here. We had had two construction agreements with the Government of Japan; that is, architectural design and construction services agreements. Neither had been adhered to for reasons that are now apparent, which is to say that there was rampant corruption with respect to that sector in Japan.

We, at the end of the second agreement when it became apparent to the U.S. Government that there was no market access in Japan in this sector, identified Japan under title VII of our trade laws and threatened sanctions. The Japanese Government on its own had come forward with a voluntary plan which looked very good

and had in it a variety of issues of concern to the United States, and we removed the identification of Japan under title VII.

With respect to the cellular telephone issue, we had two government-to-government agreements and a letter of commitment spanning almost a decade and no market access. We then identified Japan under section 1377 of our trade laws which pertains to telecommunications trade. In advance of our publishing the list, our government and the Government of Japan reached agreement, a very results-oriented agreement, with respect to the buildout of that cellular system.

So in this administration's history with Japan, we have two examples where affirmative action was not taken by the Government of Japan, despite the fact that there was a number of preexisting trade agreements until the United States got very serious about these obligations. I think this is an unfortunate pattern.

Our hope in proposing the framework was that we could get out of that cycle by having a mechanism in place for the detailed and routine negotiation of issues of importance to the United States which could be resolved by agreement, but thus far we have not ourselves achieved that goal.

Mr. GREEN. It seems like, just within your testimony, with the number of agreements that have not been lived up to, after awhile we have no other choice except to go to the ultimate solution to say, "Well, then, we just will close our markets," because that has to get to that point. Maybe Japan or any other country that's in that same situation should understand that. The U.S. Government is serious about that, particularly when you are talking about the numbers, the $59 billion that we have.

Let me ask, is there an administration position on H.R. 3900, Majority Leader Gephardt's bill?

Ms. BARSHEFSKY. Yes. We welcome, of course, the support of Mr. Gephardt and his cosponsors for the results-oriented approach of the administration. As an administration, we have not reviewed the details of the proposal either with Mr. Gephardt or with the other cosponsors. We would need to do that before indicating a position.

Mr. SHAYS. Would the gentleman yield on that question?

Mr. GREEN. Yes.

Mr. SHAYS. I'm unclear by that response. Doesn't his bill have specific quotas and state we've got to have equal balance of trade? I mean, if that's true, then for you to answer the way you've answered and then say that you haven't reviewed this bill seems to me like you're saying two different things.

Ms. BARSHEFSKY. No. I'm not that familiar with his bill. As I read it initially, it seemed to me to be somewhat inflexible with respect to quantitative and qualitative factors and what would happen with those factors, and that is of concern. I don't read it as a bill that would require any balancing of trade. There seemed to be in his description of the bill some greater discretionary element than actually appears in the bill. There is some substantial confusion about the issue of discretion.

This administration feels that it has already made Japan a priority, and that it is pursuing issues with respect to Japan under the framework, and we are doing so in a manner we believe which will,

at the end of the day, achieve results. We are not in a position, because we have not looked at this bill as an administration, to give you a firm position on the bill except to say that there are certainly aspects of it that appear to be rather inflexible, and that is of concern.

Mr. SHAYS. I thank the gentleman for yielding.

Mr. GREEN. Well, I guess I had the impression that the bill set objective criteria similar to what the administration has been talking about and the trade representative instead of the specifics that my colleague Congressman Shays mentioned.

Ms. BARSHEFSKY. It is a situation where the bill may be using some of the same language as in the framework.

Mr. SHAYS. That's what he said.

Ms. BARSHEFSKY. But "may." I would have to look at the bill more carefully than this, but maybe interpreting that language in a somewhat different way.

Mr. GARTEN. OK. Thank you, Mr. Chairman. I thank the panel.

Mr. SPRATT. Thank you, Mr. Green.

Mr. Horn.

Mr. HORN. Thank you very much, Mr. Chairman.

I will submit my statement for the record.

[The prepared statement of Mr. Horn follows:]

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Opening Statement of
Congressman Stephen Horn

House Committee on Government Operations
Subcommittee on Commerce, Consumer, and Monetary Affairs

March 23, 1994

Mr. Chairman, I welcome the opportunity to continue the topic of our earlier hearing on U.S.-Japan trade relations. You are to be commended for devoting so much of your time to this issue -- it is obviously very important to our national interest that we have access to markets in Japan and that we avoid a trade war.

The Pacific Rim will form the basis of our future trading successes. The high rates of economic growth in the area have led to shifting trading patterns for America. Asia accounts for an ever greater proportion of our trade, Europe ever less. And Asia's economic growth has not brought the kind of stability that we would all like to see. From nuclear weapons in Korea, to political succession in China, to domestic problems in Russian Siberia, Asia has the potential to be a flashpoint for conflict. So I think it is important to have this type of hearing, to examine the economic relationship between the United States and Japan, the two largest economies in the world. I would like to see a U.S.-Japan relationship based on mutual prosperity and interest in opening markets in Asia.

My district includes the Ports of Long Beach and Los Angeles, so I can tell you that my constituents care very much about Asian trade. Japanese foreign direct investment has meant many jobs for my. I look forward to the day when American foreign direct investment in Japan will mean more jobs and market share for our exporters. Southern California is still experiencing difficult economic times. Trade-driven growth will rehabilitate the Southern California economy -- with NAFTA passed, we need successful GATT legislation and increased trade with Asia. This will ensure that the comparative advantages which our country possesses will be exploited, for the good of Americans, Japanese, and every other trading people.

Mr. Chairman, you and the staff have assembled a most distinguished group of policymakers and economists. I look forward to hearing their testimony.

Mr. HORN. Let me ask, first, a question about those firms in the United States that are largely owned or almost exclusively owned by the one Japanese firm or the other, the so-called transplants. As I understood it, when we began these negotiations, the statement of U.S. Trade Representative Kantor was that there would be no discrimination against U.S. firms as part of the negotiation strategy.

I think all of us that have that type of firm in our district have been receiving dozens, sometimes hundreds of telegrams from employees, obviously generated, claiming there is some discrimination. I'm just curious, what is the position of the American Government on using transplants as part of the negotiating strategy with Japan?

Mr. GARTEN. We are not discriminating at all. A firm that is located in the United States and that is creating jobs in the United States, regardless of its capital affiliation, is an American firm for the purposes of what we are talking about. I realize that there has been a huge campaign on the part of firms located here, owned by Japanese. But I think it is totally misplaced and it has raised a lot of fears that bear no relationship to how the administration is proceeding.

Mr. HORN. So if we sent all that mail down to you, you have no examples that would fall into that claim that is being made?

Mr. GARTEN. As a matter of administration policy, no.

Mr. HORN. Well, how about administrative implementation of administration policy?

Mr. GARTEN. No, no.

Mr. HORN. OK. So you claim we're innocent?

Mr. GARTEN. Yes.

Mr. HORN. All right. Let me ask you a question now. I happen to be a hard-liner type. I think the only thing the Japanese understand is when you get tough with them and they know you're serious. They come to the hearings. They watch all of what we do. They go away smiling—another day, another year, another decade.

What I'm curious about is, you seem to be saying the ball is now in the Japanese court. What if they simply let the clock run out? What are you going to do? Where is the heavy cannon coming from, in a treaty negotiation sense, to get their attention?

Ms. BARSHEFSKY. Congressman, as you know, there are a variety of U.S. trade laws that we have that have been very effective with respect not only to Japan but other countries as well. We have section 301, we have section 1377 for telecommunications issues, we have title VII for government procurement issues, we have Super 301 by Executive order. We also have multilateral means of redress to the extent issues fall under multilateral discipline, that is: GATT dispute settlement and eventually the WTO, when that comes into force and effect.

There are a variety of tools which can be used by the United States to ensure that our goals of market access are met. I think that it is quite clear from the way in which this administration has handled European procurement issues as well as the way we have handled Korean telecommunications issues and issues pertaining to Japanese construction and cellular telephones, we won't hesitate to use the laws that Congress has given us to ensure market access.

Mr. HORN. Do you think the Japanese are convinced that you won't hesitate?

Ms. BARSHEFSKY. Yes.

Mr. HORN. OK. So they have gotten the message privately, not just press releases and speeches?

Ms. BARSHEFSKY. They have gotten the message in construction, and they have gotten the message most recently with respect to cellular telephones.

Mr. HORN. Speaking of multilateral impact and cooperation, the European Community and Australia also have a sizable trade deficit with Japan. Is there a reluctance of the European Community and Australia to work with us in a common strategy in reference to Japan? What is our relationship with them?

Mr. TARULLO. Congressman, first, I believe, although I don't have the figures with me, that Australia actually runs a modest trade surplus with Japan which puts them in a reasonably unique position.

Second, with respect to what we have heard from countries generally, I think that part of this goes back to what Congressman Green was talking about a few minutes ago, the perceptions in the world as to what we are asking for. Part of what we have been doing at the State Department and part of what USTR and the Commerce Department have also been doing has been to explain more thoroughly to the rest of the world exactly what it is that we are asking for.

I would say that on the issue of goals there is virtual unanimity. There is widespread agreement that the Japanese market is closed relative to other industrialized countries' markets. Where one does get a dispute from time to time is on the issue of tactics in pursuit of that goal.

I think that there are several factors that are currently affecting countries' perceptions of our trade relations and trade policy toward Japan. I think part of it is that misapprehension of U.S. positions, I mentioned a moment ago, and that Under Secretary Summers, I think, effectively clarified.

Two, I think there is a sort of generic concern about trade wars and the effect that they might have. We have been quite clear that we neither expect nor want a trade war. I think there are some fears, to be honest, that we might actually be effective in achieving what we are trying to achieve. It is important to point the rest of the world to the fact, that as the framework indicates, we are opening markets on a most-favored-nation basis.

Finally, I don't discount the bit of disingenuousness from time to time by other countries in finding an opportunity to take a shot at the United States on its trade policy.

I will say this, I think when we succeed in opening markets, when Japan takes steps to achieve a highly significant reduction in its current account surplus, we will not see complaints or carping, instead we will see appreciation of the fact that major imbalances in the world economy have been rectified.

Mr. HORN. When we open markets, to what degree has our experience been that the others who have sat back and let us take the lead on it get most of the business?

Mr. TARULLO. Congressman, I think that differs from case to case. It probably depends, if you're talking in sectoral terms, on the competitiveness of the industries at issue.

We have quite intentionally focused on competitive U.S. industries precisely because it was our view that their relative exclusion from the Japanese market indicated a problem. We can and have made a strong case that these are internationally competitive industries.

To the extent that other countries have world-class firms in the same industries, they will profit. I think when one turns to multilateral context, broad-based market opening measures, there you see an obvious sharing of benefits.

Mr. HORN. I think it is no secret, and we don't necessarily agree with this characterization, but people on Capitol Hill traditionally, and this might be two centuries of an attitude here, look to the State Department often as the representative of the foreign government more than the representative of the U.S. Government to the foreign government.

On this issue, is the administration united between Defense, State, and the U.S. Trade Representative on a common policy, or is it being undercut in some of our wonderful bureaucracies around town?

Mr. TARULLO. If I can start with that, Congressman, I have heard that about the State Department in the past as well. That was the pre-Christopher State Department and the pre-Clinton administration. I don't think there is any doubt about the unanimity and unity of the administration on this issue. Secretary Christopher and Ambassador Kantor I know have spoken frequently on the issue. Secretary Brown, and Secretary Bentsen have also been involved in numerous meetings with them.

My observation has been one of complete solidarity among the Cabinet and a confluence of views also shared by the President. I think that no one should be under any illusions that there are openings, there are seams in this administration. There are none.

Mr. HORN. I take it Commerce has an opinion on this also?

Mr. GARTEN. I endorse what Mr. Tarullo said 100 percent. I think that if you looked at Secretary Christopher's recent trip to Japan, that alone is evidence that there has been a huge sea change relative to any past administration. We are very much on the same wavelength. It's not just cooperation, but I think each agency is reinforcing the efforts of the other.

You know, I served in three previous administrations, so I have some comparative standard. I can tell you this is so different on the question of Japan. In fact, on the question of all of the foreign economic policy, it really is a highly united team.

Mr. HORN. Well, that's good to hear. U.S. Trade Representative, how do they feel about it?

Ms. BARSHEFSKY. Exactly the same. We think Japan policy has been very effectively coordinated through the National Economic Council in the White House. That helped certainly early on in the administration to ferret out the positions of the various agencies and to achieve a kind of consensus view that is comfortable for all of the agencies, both in terms of their individual institutional roles

as well as comfortable with respect to the individual personalities who are the chief negotiators.

This has been a very coördinated effort, and I say this as someone who has practiced in the international trade field for almost 20 years.

Mr. HORN. Let me move to the last question, Mr. Chairman. I understand, Ms. Barshefsky, that in response to testimony you noted we have no specific targets with relation to Japan, but later you noted that the framework agreement collapsed because the Japanese won't commit to quantitative factors to measure progress. So we have no specific targets, but we do have quantitative factors of measurement. What are they if there are no specific targets?

Ms. BARSHEFSKY. Well, let me give you some examples. In the case of telecommunications, we have a variety of qualitative and quantitative factors that we put forward as a means of assessing implementation of the agreements.

On the qualitative side, they included such things as: United States and foreign company efforts to penetrate the Japanese market; the accessibility of pre-tender information to foreign entities so that they knew what procurements were coming online; the accessibility of pre-tender conferences to foreign entities so they could participate fully; the accessibility of the standards and specifications-setting process to foreign entities so that standards and specifications could not be set with the objective of intentionally discriminating against foreign products.

On the quantitative side, we put forward such factors as a decrease in sole sourcing of procurements within telecommunications trade, as well as an overall increase in market access so that Japan's procurement regime would come more closely in line with that of the other G–6 countries than it is currently now.

Mr. HORN. Let's just stop at sole sourcing a minute to give me a feel for how we set up the quantitative measurement system. You have knowledge, then, of all sole sourcing that has been done based on previous procurement?

Ms. BARSHEFSKY. We have some information. We have in these proposed agreements a separate section on datapoints. One of the datapoints that we have asked for is the percentage of sole sourcing relative to total procurements in a given year or actually half yearly basis.

Mr. HORN. These are percentage by contracts issued?

Ms. BARSHEFSKY. It would be, yes, by bids awarded.

Mr. HORN. Does it relate to total amount of the bid? In other words, you can have 50, $2,000 contracts and one $2 billion contract.

Ms. BARSHEFSKY. Yes. It is both by value as well as by number of bids to try and give it exactly the distinction that you are making. But in terms of the quantitative factor that we would look at, we have used the word "decrease." We want to see a decrease in the percentage of contracts awarded by sole sourcing.

Mr. HORN. And in relation to amount and volume?

Ms. BARSHEFSKY. And in relation to amount and volume, correct.

Mr. HORN. OK. What are some of the other quantitative ones?

Ms. BARSHEFSKY. We have asked for an increase in the value of procurements such that Japan's procurement regime moves more

in line with the regimes of the G–6 countries, the other major industrialized countries. There we are looking at an extension of previous trends, what has been the trend in the marketplace relative to deregulation, and what that trend would look like in the future relative to additional deregulation of the government procurement market.

Mr. HORN. How about on qualitative factors, anything else besides what you mentioned?

Ms. BARSHEFSKY. I would have to look back at the individual agreements. There are a variety of additional both quantitative and qualitative. It's hard to remember every one offhand, but I think in each agreement we had in combination of a minimum of seven or eight different evaluative factors we would look at in assessing implementation and market access.

Then in each agreement we had perhaps 8 or 10 series of data collection points. Some data would be supplied by the U.S. Government, some would be supplied by the Government of Japan relative to total volume, value, to foreign participation versus domestic participation in procurements or in the insurance sector, so on and so forth.

Mr. HORN. Now, are there breakthroughs you have already seen based on this quantitative, qualitative analysis in getting all the data out on the table? Can we attribute anything to that approach?

Ms. BARSHEFSKY. Well, I think we can look at the cellular telephone agreement, which is a highly specific results-oriented agreement. I think we can say that agreement was informed by the negotiations that had taken place under the framework.

So that with respect to the cellular telephone agreement, we have in place with the Government of Japan, by quarter, specific obligations which the government and their agent will undertake in terms of building out the cellular system in terms of the number of bay stations and voice channels, geographic coverage, population coverage, so on and so forth, leading to the point in 21 months where the system is fully deployed and fully operational. That is a highly detailed, results-oriented agreement.

By the same token, there is no guarantee of market share to North American purchaser—or North American equipment providers. There is, however, the guarantee that a system that was promised to be built will, in fact, be built. We know from other areas of Japan outside of the corridor involved with this system, Tokyo and Nagoya in other areas of Japan that where the North American analog system is allowed to compete, it competes head to head with NTT.

Mr. HORN. I take it you have not yet experimented with exporting the Sherman Antitrust Act and the Clayton Antitrust Act and the thousand lawyers who speak Japanese?

Mr. Chairman, it's all yours. [Laughter.]

Go ahead, if you want to answer that one.

Mr. TARULLO. No.

Mr. SPRATT. I beg your pardon? I was sending word for Mr. Chimerine that there's a seat up front if he would like to come up here, I'm sorry, and I lost the thread of it.

Mr. HORN. It's all yours.

Mr. SPRATT. Thank you, I've got two or three quick wrapup questions, and Mr. Cox may have one. We would like to move on with it. I'm sure you would like to move on to other things as well.

Basically, now we have a collapse of the talks on February 11. As I listen to you talk about qualitative and quantitative objectives, you have still got those laid out before you. Did the framework collapse with the break down of the talks? Do we still have a structure in place that we intend to adhere to, follow, at least use as a process for approaching these problems?

Ms. BARSHEFSKY. Certainly, the framework document as a document is viable. Neither the United States nor Japan have disavowed the framework. On the other hand, there are no talks proceeding at present under the framework. As the Japanese Government itself has said, the ball is in their court.

We understand that they will come out with some unilateral package of market access measures, I believe by the end of the month, perhaps shortly after the end of the month. The United States will certainly look at that package and assess whether that moves in a manner in accord with the framework and whether it is significant at all.

Mr. SPRATT. All right. So what role, then, does Super 301 play, the invocation of it, the reinstatement of it by Executive order? Are these two things coupled? Is this an effort to bring pressure to bear, to bring light back to the so-called framework?

Ms. BARSHEFSKY. Well, as you know, Super 301 was issued by Executive order by a President which during his campaign, and then quite frequently during the first year of his presidency, endorsed Super 301. Even had we reached successful agreements by February 11 under the framework, Super 301 would have been issued by Executive order by the administration.

Now, we didn't designate countries' practices under Super 301 when we issued it by Executive order. That designation is not made until next September. Certainly, the framework itself makes Japan a high priority for the United States, as well it should be, and we would hope to pursue fruitful negotiations in the context of that framework.

To the extent there are ongoing negotiations with Japan or any country and to the extent we are making substantial progress toward market access, the Executive order gives the USTR discretion not to name a particular practice in that country.

Mr. SPRATT. Now let me ask you about two particular sectors, and then we will wrap up. First of all, if there is going to be a solution to the enormous deficit we are running with Japan, it has to include to some extent automobiles and automotive parts. It is such a large part of the problem; you can't solve the whole thing without having the solution there. Are you confident that we are on our way to a solution dealing in particular with automotive parts? Do we have the elements of a workable solution here; and if so, what are they?

Mr. GARTEN. Well, I think we have proposed the elements of a reasonable plan. I don't want to use the word "solution" because I think it presupposes that there is a goal of equal balance, as we talked about before. I don't know whether that is achievable but it is not the way we are setting out to look at this. We see this as

a market access problem, that there are barriers to the sales of American auto parts to Japanese companies and that there are barriers to the sale of vehicles.

We have put on the table four principal points, quite a few more, but there are four principal points that we think would go a long way toward removing some of these barriers. One of those points is that there are a variety of deregulatory measures that the Japanese Government can take. It's totally within their control. It has to do with removing or simplifying inspection procedures, certification procedures which have been barriers and very costly to American imports.

Second, the balance of parts, particularly in the parts area, has been getting worse even as Japanese companies have been locating in the United States and they have been buying. It is part of the keiretsu system and many of the parts purchases come from their own companies. You know, we would like to see an increase at least in the parts that are purchased in the United States.

Mr. SPRATT. How do we use the Japanese Government's leverage to require Japanese automobile firms to resource more of their parts in the United States?

Mr. GARTEN. Well, when it comes to the first category, deregulatory measures, that's totally in the Japanese Government's control. When it comes to sales of parts or sales of automobiles, the fact is that a lot of this is not in the Japanese Government's control at all. We think that the Japanese Government can have some influence on their companies because the ties between the government and business tend to be much closer than they are here.

But basically it's going to be the responsibility of the Japanese industry itself to step up to the plate and to conduct its business, the way our companies do, in an open competitive way. So we have been hoping that not just the government but also the Japanese industry really takes responsibility for this.

Mr. SPRATT. One final question, and that concerns forest products, wood and paper, which seems to me to be a telltale indication of the Japanese Government's attitude about free and open trade. Because this is clearly an area where we have a competitive advantage worldwide, and clearly they have been resistant as recently as the GATT talks. They were resistant to the zero-zero proposition we put forward.

If they wanted to work out a solution, this would at least be one sector where they could make concessions to us that would be effective and probably would benefit them in a classical economic sense, because we've got an economic advantage in producing these products. Yet, we haven't been able to induce the Japanese to buy our finished wood products. They would not go to zero tariffs with us on wood products; they would on paper products, but that has to be extended over a 10-year period of time.

How do we explain that attitude, and what do we do about it in the context of the framework talks?

Ms. BARSHEFSKY. Mr. Chairman, as you know, the United States pushed Japan very hard on the wood issue. Because you're quite right, this is an area where the United States has a competitive advantage. It's an area where the United States had zero-zero commitments from a variety of countries including the European

Union, and those commitments have now been drawn off the table by our other trading partners because Japan would not move effectively in the wood sector.

I think this is an issue that to the extent we cannot make further progress in the round—and as you know we're still in this process of rectification of market access offers, so perhaps there is some slight possibility, although I'm not optimistic—but if we can't make further progress in the round, I think we're going to have to deal with this issue again bilaterally.

We must appreciate the subject of wood and wood tariffs has been on the table with Japan since the mid to late 1980's. We are going to have to go back at that issue again to the extent Japan will not go to zero for zero on wood in the round.

Mr. SPRATT. Well, does Super 301 give us leverage or a tool we can use in this sector?

Ms. BARSHEFSKY. Super 301 may give us some leverage.

Mr. SPRATT. Those are all the questions I have. Unless other members have other questions to ask, we will—Mr. Cox.

Mr. COX. I would just like to follow up on two points. First, with respect to the quantitative factors of measurement which are to be distinguished from specific targets. I heard you say in response to Congressman Horn's question that the quantitative factor of measurement, or a quantitative factor of measurement that we would be using, is overall increase in market access.

I understand that the United States suggested that an example of such a measurement would be import penetration in the European Union in specific sectors such as computers and insurance. Can you illustrate how that would work? Tell me if my CRS information is wrong.

Ms. BARSHEFSKY. No, that's not correct. What we have said to the Japanese is that we can look on a macro level and we can look on a sectoral level, and we see very substantial economic asymmetry between the way in which the Japanese market operates in that sector, for example, and the markets of other industrialized nations.

We can look at telecommunications, as I indicated in my opening statement, and see that telecommunications, global telecommunications equipment penetration into Japan is 5 percent. Global telecommunications penetration into the G–7 less Japan is 25 percent. We have not put forward that disparity by way of saying, "Japan, you should be at 25 percent." What we have said is there is obviously a disparity here of substantial magnitude.

Japan's telecommunications market, and there are a variety of barriers one could point to, is not as open as some of the markets of its major industrialized trading partners. Let's try and move toward greater market opening. But we have not set out a European or any other standard for Japan to replicate. No two economies are the same.

Mr. COX. That will measure import penetration in Europe and compare it in import penetration in Japan?

Ms. BARSHEFSKY. No, we're not measuring import penetration into Europe. What we are saying is there are trends currently now in the Japanese market that are only recently apparent based on

deregulatory measures that have been taken which have spawned an increase somewhat of foreign telecommunications equipment.

If we posit that the agreements we have put forward will further deregulate the Japanese Government procurement process, which they will because these are largely deregulatory arrangements, we would like to see a continuation or an acceleration of some of those trends as one might——

Mr. COX. And that strikes me as qualitative. I'm just trying to get at the quantitative aspect.

Ms. BARSHEFSKY. We view that as quantitative; one could view it as qualitative.

Mr. COX. But what is the quantity we're measuring, then?

Ms. BARSHEFSKY. We would be looking at a trend, basically at a trend of continual access based on the expected outcome from deregulation.

Mr. COX. An access as measured by?

Ms. BARSHEFSKY. Value. Value, typically.

Mr. COX. Value of what compared to what?

Ms. BARSHEFSKY. Well, one could look at volume of sales or value of total procurements.

Mr. COX. Volume of sales by whom?

Ms. BARSHEFSKY. Foreign producers in total.

Mr. COX. As a percentage of?

Ms. BARSHEFSKY. It could be as a percentage of the market or in an absolute sense.

Mr. COX. All right. If it's as a percentage of the market, isn't that called market share?

Ms. BARSHEFSKY. We are not saying you would never not look at market share.

Mr. COX. OK. The reason I asked this is that——

Ms. BARSHEFSKY. That's a legitimate factor, but what I'm saying is——

Mr. COX. What I would like to ask for the record—and I want to yield back to the Chairman very quickly because I know we have a second panel—but as I stated at the outset, if in negotiating with foreign countries we are not quite clear, then the opportunities for language, cultural differences, and so on to expand our differences itself expands.

If we have trouble as Members of Congress understanding what you're saying in English, I can't imagine how it translates into Japanese. So what I would ask is that for the record you list the specific quantitative measurements that you are speaking of in plain English, you know, in a short sentence, and list as many of them as you are currently preparing to propose so that we can at least understand them.

Finally, Japan is an importer of energy, and we ought to be interested, it seems to me, to sell them things they need to import. Specifically, they are importers of oil. The Alaskan North Slope produces oil. The United States prohibits Japan from buying Alaskan North Slope crude.

The result is that even though Alaska is nearby to Japan the tankers from Alaska come down the Pacific Coast—Canada, Washington, Oregon, and California, where I'm from—creating an environmental risk of oil spills on our beaches, estuaries, and wetlands.

The Alaska crude is lighter than the California crude, and therefore it destroys the opportunity of California producers to sell in their own back yard, and we get the tanker traffic instead. So our California producers are disadvantaged, our Alaskan North Shore producers are disadvantaged because they can't sell to Japan. Japan is disadvantaged because they can't buy it.

It strikes me that it would be a win-win proposition for us to permit the sale of Alaskan North Slope crude to Japan. Is the administration willing to propose this as a carrot in the negotiations?

Ms. BARSHEFSKY. This has not been the subject of administration discussion of which I'm aware.

Mr. COX. Would you make it the subject of your discussions and report back your position on it, Commerce in particular, and USTR and Treasury and so on.

Mr. GARTEN. Certainly.

Ms. BARSHEFSKY. Surely.

Mr. COX. I would very much appreciate that. I want to say I thank the panel very much for stating in an over-arching way that managed trade is not our goal, that managed trade with its targets for market share and so on would take us down a course we don't want to pursue. I appreciate your clarifying that this morning.

Thank you very much.

Mr. SPRATT. Thank you very much for coming, for your forthright answers, and not least for your forbearance. We very much appreciate it, and we look forward to working with you on this topic in the future. Thank you so much.

Mr. SPRATT. Our next panel is composed of William Niskanen, who is chairman of the board of the Cato Institute; Gary Saxonhouse, who is a professor of economics at the University of Michigan; and Larry Chimerine, who is the vice president and chief economist of the Economic Strategy Institute.

Since we have listed your names, William Niskanen first, then Gary Saxonhouse, and Larry Chimerine, if we go in that order, is that satisfactory with you?

Mr. NISKANEN. It's fine with me.

Mr. SPRATT. OK, fine. Thank you very much for coming. Just as a formality, I think we have just received the prepared testimony of Dr. William Niskanen, and we will make it part of the record, if there is no objection. The same for Lawrence Chimerine, we will make his testimony a part of the record.

Dr. Saxonhouse, do we have your testimony, prepared testimony?

Mr. SAXONHOUSE. You don't have it. The minority counsel suggested I didn't need to prepare one in advance.

Mr. SPRATT. That's OK, fine.

Mr. SAXONHOUSE. I will be happy to send one, though, for the record.

Mr. SPRATT. Dr. Niskanen, the floor is yours to begin.

## STATEMENT OF WILLIAM A. NISKANEN, CHAIRMAN OF THE BOARD, THE CATO INSTITUTE, MEMBER OF PRESIDENT REAGAN'S COUNCIL OF ECONOMIC ADVISERS

Mr. NISKANEN. Thank you, Mr. Chairman. I am pleased for this opportunity to testify on the several proposed framework arrangements for United States-Japan trade.

I conclude that Congress should terminate the negotiations on these proposed arrangements. The U.S. position on these proposed arrangements is deeply offensive to the Japanese. It threatens to undermine the most reformist Japanese Government of the postwar years. It is based upon several false premises. It would undermine the rule of law in international trade, and it risks actions with serious adverse consequences to Americans.

Let me count the ways. These arrangements as proposed by our government would require the Government of Japan to "actively facilitate and support" the purchase of foreign goods and services by consumers and firms in Japan and by Japanese firms in the United States and in Third World countries.

The demands by our government include changes in Japanese domestic regulations and tax provisions, government guidance letters to Japanese firms, and Japanese Government trade fairs and symposia to promote the purchase of foreign goods and services. These negotiations are entirely unilateral.

The United States has put nothing on the table in these negotiations except a thinly veiled threat of sanctions if their demands are not met. These demands are deeply offensive to the Japanese who properly regard them as an infringement on their sovereignty. I ask you to sit on the other side of this table for a moment to recognize that Americans would be outraged if another government made similar demands on the U.S. Government.

Second, the coalition led by Prime Minister Hosokawa is committed to political reform, domestic deregulation, and to tax reform, measures that will benefit both the Japanese and indirectly benefit Americans. Continued U.S. trade pressure or the imposition of sanctions outside of violations of particular agreements could undermine this fragile Japanese coalition.

Three, the U.S. position on these negotiations is based upon several false premises. First, contrary to the perception apparently of most people, the Japanese economy is relatively open. The average Japanese tariff and the range of products covered by quantitative import limits are now the lowest among the major industrial nations, lower than in the United States.

United States exports to Japan have increased rapidly in the past decade, and on a per capita basis are now higher than American purchases of Japanese products. Japanese buy more per capita of American products than Americans buy per capita of Japanese products.

Second, the large Japanese trade surplus is a mirror image of their large net capital outflow, and it would not be significantly changed by any conceivable set of trade measures.

Third, the large U.S. trade deficit reflects our position as the world's largest net borrower and, again, would not be significantly changed by any conceivable set of trade measures. Our trade deficit reflects a problem, and that problem is our unusually low net saving rate.

Our private saving rate fell very sharply in the eighties and we continue to have a Federal deficit that is much too large. Our net saving rate in recent years has been on the order of 2 percent. The trade deficit that we have is primarily a consequence of that problem, but the trade deficit by itself is not a problem.

In the absence of the large net inflow of capital, our domestic investment would be reduced to the level of our net savings. Many potential investments by private firms and individuals and by State and local governments would be crowded out. At the moment maybe $100 billion of that investment.

Finally, U.S. officials have, I think, substantially overestimated our leverage on the Japanese, based upon the recognized fact of the relative importance of access to our very large market. Three conditions, however, have severely reduced our leverage over the Japanese in recent years. With the end of the cold war, the Japanese are no longer dependent, or are less dependent, upon the United States for a security guarantee, as are our other major cold war allies.

Second, our large net borrowing makes it important for Americans to have access to the Japanese capital market. The most severe potential Japanese countersanction, for example, would be to instruct their financial houses not to show up at U.S. bond auctions.

And, finally, the new generation of Japanese political leaders, intellectuals, and journalists have a quite different attitude toward the United States than the older generation who came to maturity during World War II in the immediate post-World War II years. They are sophisticated, are cosmopolitan, many of them speak English, and they are much quicker to speak up in Japanese interests, much less willing to acquiesce to U.S. pressure than has been the case in the past. Prime Minister Hosokawa's resistance to U.S. pressure in February, for example, was quite popular at home.

Fourth, the proposed framework agreements represent a substantial erosion of the rule of law in international trade. Several provisions of the proposed arrangements are directly contrary to the national treatment standard, which is the shared principle in most trade and investment agreements.

Japan's large trade surplus is not a violation of any trade or investment agreements. The fact that Japan's domestic regulations, taxes, and business practices are somewhat different from ours is also not a violation, any more than the fact that our domestic taxes and regulations and business practices are different from the Japanese is not a violation of trade agreements.

But it is these two conditions, our substantial trade deficit with respect to Japan and the fact that their practices, both governmental and business practices, are somewhat different from ours that has been at least the proffered rationale for the kinds of measures that we are demanding of the Japanese.

In the absence of a clear violation of some existing agreement, the threat and the use of sanctions to achieve an outcome preferred by some U.S. party is an illegitimate act. It is the tactic of a bully. The difference between what we have been doing for some years and what has been the general practice of trade negotiations is that particularly with respect to Japan for about a decade we have been saying, "Do what we demand, or we will impose sanctions on you."

That is very different from the environment of trade negotiations in which there is a trading of concessions in which if you do something we like, we will do something that you like. These negotia-

tions with Japan have all too often been strictly unilateral and the tactics of a bully.

The administration has made a point of saying, "Well, we are not involved in a trade war, and we are not going into a trade war." The kinds of measures the administration has threatened and implemented, however, are the instruments of a trade war. They are measures that are not sanctioned by agreements to which the two affected parties have agreed.

Finally, Americans need to be reminded that a trade war, like any war, has casualties on both sides. Any sanctions imposed by the U.S. Government, for example, would harm American consumers because of the products subject to the sanction. It would harm American firms that use these products or services in their own production processes or are involved in the resale of those goods and services. It would harm American exporters of goods and services that are not involved in the immediate dispute.

Trade measures that are not authorized by GATT or by other bilateral and regional trade agreements also reduces the potential to resolve other disputes where our firms may very well be subject to unfair trade practices through these regional or worldwide agreements.

For about 50 years, beginning with the Reciprocal Trade Act of 1934, initiated by Cordell Hull in the Roosevelt administration, the U.S. Government led the effort to develop a rule of law in international trade, backing away from the terrible Tariff Act that was put in place in 1930.

A sad development of the past decade is that the U.S. Government has also been the major bully of world trade. The proposed framework arrangements are the demands of a bully and they should be terminated. For a more enduring resolution of several problems that we perceive to be trade problems, Congress should put our own fiscal house in order, and it should encourage the administration to focus trade policy on a continued broadening of the scope of trade covered by mutually agreed rules of trade. Thank you.

[The prepared statement of Mr. Niskanen follows:]

Hearings on U.S.-Japan Framework Talks

Testimony
by
William A. Niskanen
Chairman
The Cato Institute

Subcommittee on Commerce, Consumer, and Monetary Affairs
House Committee on Government Operations
Washington, D.C.
23 March 1994

Mr. Chairman and members of the Subcommittee:

I am pleased for this opportunity to testify on the several proposed "framework arrangements" for U.S.-Japan trade. Congress should terminate the negotiations on these proposed arrangements. The U.S. position on these proposed arrangements is offensive to the Japanese, threatens to undermine a Japanese government committed to domestic economic reform, is based on false premises, would erode the rule of law in international trade, and risks actions with serious adverse consequences to Americans. Let me count the ways.

1. These arrangements, as proposed by our government, would require the Government of Japan to "actively facilitate and support" the purchase of foreign goods and services by consumers and firms in Japan and by Japanese firms in the United States and third countries. The demands by our government include changes in Japanese domestic regulations and tax provisions, government "guidance letters" to Japanese firms, and government-sponsored trade fairs and symposia to promote the purchase of foreign goods and services. These negotiations are entirely unilateral; the U.S. Government has put nothing on the table except a thinly veiled threat of sanctions if these demands are not met. These demands are deeply offensive to the Japanese, who regard them as an infringement on their sovereignty. Americans would be outraged if another government made similar demands on our government.

2. The coalition led by Prime Minister Hosokawa is committed to political reform, domestic deregulation, and tax reform--measures that would benefit both Japanese and, indirectly, Americans. Continued U.S. trade pressure or the imposition of sanctions could undermine this fragile coalition.

3. The U.S. position in these negotiations is based on several false premises:

a) First, contrary to the perception of many, the Japanese economy is relatively open. Average Japanese tariffs and the range of products covered by quantitative import limits are now the lowest among the major industrial nations. U.S. exports to Japan have increased rapidly and, on a per capita basis, are now higher than American purchases of Japanese products.

b) The large Japanese trade surplus is the mirror image of their large net capital outflow and would not be significantly changed by any conceivable set of trade measures.

c) The large U.S. trade deficit reflects our

position as the world's largest net borrower and, again, would not be significantly changed by any conceivable set of trade measures. Our trade deficit reflects a problem--our unusually low net saving rate--but is not, by itself, a problem. In the absence of the net inflow of capital our domestic investment would be reduced to the level of our net saving, and many potential investments by private firms and individuals and by state and local governments would be crowded out.

d) U.S. officials have also overestimated our leverage on the Japanese, based on the relative importance of access to our large market. Three conditions, however, has severely reduced our leverage over the Japanese. With the end of the Cold War, the Japanese are no longer as dependent on the United States for a security guarantee. Our large net foreign borrowing makes it important for Americans to maintain access to the Japanese capital market; the most severe potential Japanese counter-sanction, for example, would be to instruct their financial houses not to show up U.S. bond auctions. And the new generation of Japanese political leaders, intellectuals, and journalists have

a quite different attitude toward the United States. Hosokawa's resistance to recent U.S. pressure, for example, was quite popular at home.

4) The proposed framework arrangements represent a continued erosion of the rule of law in international trade. Several provisions of the proposed arrangements are directly contrary to the national treatment standard, which is the shared principle in most trade and investment agreements. Japan's large trade surplus is not a violation of any trade or investment agreement. The fact that Japan's domestic regulations, taxes, and business practices are somewhat different from those in the United Sates is also not a violation of any agreement. In the absence of a clear violation of some existing agreement, the threat or use of sanctions to achieve an outcome preferred by some U.S. party is an illegimate act--the tactic of a bully.

5) Finally, Americans need to be reminded that a trade war, like any war, has casualties on both sides. Any sanctions imposed by the U.S. Government, for example, would harm American consumers, American firms that use or resell foreign goods and services, and American exporters of goods and services not involved in the immediate dispute. Trade measures that are not authorized by the General Agreement on Tariffs and Trade also reduces the potential to resolve

other disputes, where our firms may have been subject to unfair trade practices, through GATT.

For about 50 years, beginning with the Reciprocal Trade Act of 1934, the U.S. Government led the effort to develop a rule of law in international trade. A sad development of the past decade is that the U.S. Government has also become the major bully of world trade. The proposed framework arrangements are the demands of a bully and should be terminated. For a more enduring resolution of several problems that are perceived to be trade problems, Congress should put our own fiscal house in order and encourage the administration to focus trade policy on broadening the scope of trade covered by mutually-agreed rules of trade.

Thank you.

Mr. SPRATT. Thank you very much.
Mr. Saxonhouse.

## STATEMENT OF GARY SAXONHOUSE, PROFESSOR OF ECONOMICS, UNIVERSITY OF MICHIGAN

Mr. SAXONHOUSE. Mr. Chairman, I am pleased you have invited me to testify on the extremely important matters presently being considered by your subcommittee. Mr. Chairman, I would like to explore with the subcommittee today the question of why is it that the U.S. Government, which in the space of an incredible 4 weeks late last year, successfully encouraged the ratification of the NAFTA, hosted the Asia-Pacific Economic Conference in Seattle, and worked out the Uruguay Round agreements in Geneva, has made such a hash of the United States-Japan framework talks.

Quite simply, the premises of our diplomatic stance toward Japan are incorrect; and even if correct, the strategy and tactics used to advance American interests will not work. The President and his advisors persist in characterizing Japan's $60 billion trade surplus with us as unacceptable.

Let me remind the committee that they should know better. The balance of trade between two countries is not the bottom line of a scorecard on the extent to which trade barriers exist between them. Japan is not likely to run a trade surplus with Saudi Arabia no matter what trade policies it adopts.

No one doubts that Great Britain practiced a pristine form of free trade in the years before the First World War. Yet, during the same period year in, year out, British exports to Japan were five to six times British imports from Japan.

If trade barriers don't cause trade imbalances, what does? You have doubtless heard this before, but it does bear repeating. A country that produces more than it spends will have a trade surplus. A country that spends more than it produces will have a trade deficit. Japan's thrifty households and Japan's thrifty government make a large Japanese trade surplus inevitable. By marked contrast, our own large trade deficit goes hand in hand with our huge government budget deficit and the paltry savings rate of the average American household.

How is it that the removal of Japan's trade barriers has little or no long-term impact on Japan's trade surplus? Quite simply, when Japanese trade barriers are removed, whether for rice or for supercomputers, the laws of supply and demand dictate a cheaper Japanese yen. For example, the cheaper Japanese yen should very nearly balance off more rice or supercomputer imports with less of some other imports or more Japanese exports.

While there is persistent focus on the American industries that may be hurt by Japanese trade barriers, there are other American industries that actually benefit from Japanese restrictions. Right now, American motor vehicle manufacturers benefit greatly from Japan's very expensive yen.

Successful conclusion of all parts of the framework talks this summer might bring a cheaper yen which could hurt the automobile industry far more than anything the industry might reasonably hope to gain from the removal of trade barriers.

Is it possible that Japanese trade barriers to the extent that they exist are designed to keep out high technology products from abroad? Is Japan forcing its trading partners to be suppliers of yesterday's manufacturers and cheap raw materials? If that is Japan's aim currently, it is not doing a very good job.

Today, imports occupy 57 percent of Japan's market for scientific instruments, up from 18 percent in 1981. In chemicals, imports have grown from taking only 8 percent of the Japanese market in 1981 to where today fully 28 percent of the chemicals in Japan are imported. In common with imports of scientific instruments and chemicals, imports of computer equipment have more than tripled their share of Japan's domestic market, growing from 9 percent to 30 percent in the years between 1981 and 1992.

These are not isolated examples. As a result of some pressure from American trade negotiators, and more importantly as a result of the natural evolution of the Japanese economy, imports play a significantly more important role in Japan's high technology sectors than they did a decade or so ago.

In this light, it is hard to understand how it could be argued that nothing ever changes in Japan or that 30-odd trade agreements have come and gone without any significant improvement in foreign access to Japan's markets. And that, in consequence, an entirely new approach is necessary. In these negotiations the U.S. Government runs the risk of not simply looking misinformed but also of looking inconsistent.

On February 14, shortly after the breakdown of the framework talks, the administration's Economic Report of the President was sent to Congress. Tucked away in the report is the finding that U.S. trade barriers, particularly nontariff barriers, have reduced our own imports of manufacturers by a fifth.

How does this compare with Japanese practices? Just a few pages earlier in the President's report, it is noted that Japanese imports of manufacturers might increase by somewhat more than a fifth if its trade barriers were removed. Amazingly, at the very same time that the President has been attempting to persuade the American public that Japan's market was uniquely closed, evidence in his own economic report points to just the opposite conclusion.

Even if the premise of the United States-Japan framework talks were correct, the particular approach being employed by the administration is unlikely to bear the sort of fruit imagined. No matter what semantic games may be played—and I think the committee did very, very good work this morning in flushing that out from the American trade negotiators—Washington is asking Tokyo to agree to numerical targets for imports in particular manufacturing sectors.

To reach these numerical targets for imports, sales of Japanese-produced manufacturers will have to be restrained. Time and again, when sales of Japanese-produced manufacturers have been restrained in the American market, price increases for consumers have resulted. Recall what happened in the American market after voluntary export restraints were slapped on Japanese automobiles in the early 1980's.

Why should the result of such a restraint be any different if it occurs in Tokyo rather than in Toledo? It is one thing to ask the

Japanese Government to bless an arrangement where Americans pay higher prices to Japanese firms to protect an American industry, it is quite a different matter when the protection for American industry comes at the expense of Japanese consumers, as would be the case with what is currently being proposed.

If numerical targets are not the answer, how can the United States resolve legitimate grievances that it may have with Japan. The completion of the Uruguay Round negotiations last December was an American triumph. In retrospect it will seem hollow if we choose not to make use of some of the new agreement's most compelling features.

The new World Trade Organization established by the Uruguay Round, includes dispute resolution panels whose findings will be virtually binding on participants. While settling disputes out of court has some merit, the United States and Japan have been negotiating bilaterally to increasing acrimony for the better part of two decades.

It is high time that both governments pledge to take our disputes to the appropriate impartial international tribunal. Even where there is no specific violation of a multilateral trade agreement, where a Japanese practice nullifies and impairs benefits previously negotiated for, international dispute resolution panels are highly appropriate.

Mr. Chairman, is there any better way to help inaugurate the new World Trade Organization and to allow the international economy to enter the 21st century with renewed confidence in its multilateral trade institutions than to adopt such an approach? Thank you.

Mr. SPRATT. Thank you. Mr. Chimerine.

## STATEMENT OF LAWRENCE CHIMERINE, VICE PRESIDENT AND CHIEF ECONOMIST, ECONOMIC STRATEGY INSTITUTE

Mr. CHIMERINE. Thank you very much, Mr. Chairman. Good to see you again, and I'm delighted to appear this morning to present my views on the administration's Japanese policies. And as you can guess, they are in opposition to the views you have just heard from my two distinguished colleagues here.

Mr. SPRATT. We asked you to come to provide a counterbalance.

Mr. CHIMERINE. I assumed that was the case, Mr. Chairman.

I would note for the record our appreciation. I would like to be brief, and discuss two issues this morning, Mr. Chairman. First, I would like to lay out the evidence as I see it, and describe why I think it's completely consistent with the administration's approach; and, second, I'd like to make some comments on some of the observations made by my colleagues here during the last few moments.

I think the problem is well known to everyone here. The Japanese have run large and persistent trade surpluses for many years, despite major swings in economic conditions, huge shifts in exchange rates, fluctuation in oil prices, and shifts in financial markets. Yet, the one constant seems to be the large Japanese trade surplus, both with the world in general and with the United States, with only a very limited amount of variation in those trade surpluses, despite the sharp swings in underlying economic and financial market conditions.

In my opinion, this reflects the fact that Japan's trading patterns are different—most significantly, their propensity to import is extraordinarily low compared with virtually every other industrialized country.

In my opinion, the evidence overwhelmingly suggests that Japan's low propensity to import is not the result of traditional factors that affect imports. It is primarily the result of a lack of market access, reflecting their keiretsu system, onerous licensing and regulatory requirements for imports, a closed distribution network, and other forms of protection for many domestic industries, which make it impossible for United States and other companies to penetrate many of their markets.

Consistent with this, United States penetration of the Japanese market for almost every manufactured good, even those for which we are very competitive, is far below our comparable penetration in virtually every other major industrialized country. So I think the evidence overwhelmingly shows that there is a lack of market access in Japan.

I strongly disagree with Bill's comment that Japan is open because their tariffs are low. It isn't a tariff issue; it's an issue of the inability to penetrate the distribution network. And, in fact, despite their low tariffs, the prices of imported goods in Japan are enormously high. So there are serious problems with market access, and I don't think tariffs gets at the issue.

In my opinion, these persistent large Japanese trade surpluses have adverse effects on the global economy. Japan, in effect, exports unemployment to everybody else. They have been the cause of most trade friction around the world in recent years.

Those who infer that the administration is starting a trade war are wrong—I think the opposite is the case. Eventually, there is going to be a global backlash against the Japanese if these trade surpluses persist, while everybody else is suffering from unemployment and stagnation. The administration's effort might prevent that if it produces some results over the next several years. The status quo is also bad for Japan because it keeps prices high; it holds down their living standards and is not healthy for their consumers.

It has also caused a huge increase in the yen, which I think has bad side effects. It increases the prices of imports and inflation in the United States. It tends to keep interest rates higher than they would otherwise be; and it makes our assets cheaper for foreign companies, a strong yen is not an effective and therefore desirable solution to the problem. And it has become difficult to offset the adverse effect of these trade surpluses with monetary and fiscal policy in the United States and other countries.

There is also a composition argument; it's not just the level of the trade deficit that matters. We send Japan logs and agricultural commodities, and they are shipping VCR's, Watchman, Walkman, and automobiles—predomominantly high value-added products to the United States. The composition of trade also has an adverse effect on the U.S. economy.

There is also an economy of scale issue. The Japanese market has become large and our inability to penetrate that market denies many U.S. companies the economies of scale that are necessary on

a global basis to compete effectively, while Japanese companies will benefit from it. This might keep our cost structure high and might prevent U.S. companies from making some needed investments in the future.

I think, therefore, the problem must be dealt with. And it seems to me that two of the proposed solutions are clearly not sufficient. First, macroeconomic solutions are not enough. They will not solve the problem because it is not predominantly a macroeconomic problem. Everybody is aware of the investment and saving gap identity with the current account deficit, but that's only a statistical identity.

Causality can go in both directions. It is indisputable, in my opinion, that if Japan opens its markets and imports more, the identity will still hold. But it will hold with lower saving rates in Japan as they buy more less expensive imports, and with higher saving rates in the United States and other countries as economic activity is stimulated, generating more personal income, part of which is going to be saved.

So, because we have an identity does not mean that if Japan opens their markets, this won't openly benefit the U.S. economy and still keep the identity in place.

Second, we have tried everything else in the past. The Japanese only respond to pressure. And I don't accept the view we should take it to GATT because there is no dispute resolution panel within GATT that deals with the kinds of practices such as industrial targeting, keiretsu, and so forth, that prevent lack of market in Japan. We will get no relief from GATT.

In my opinion, what the administration is doing is absolutely right on. I'm sort of surprised everybody is accusing them of managed trade. What have the Japanese been doing for the last 20 years? That isn't managed trade? What the administration is trying to do, essentially, is to gain market access for the United States and other producers. I think that is an absolutely legitimate goal to try to achieve, and their approach, in my view, is the only way of achieving some success.

I feel very strongly that it isn't managed trade, because what they are trying to do is put quantitative measures in place to measure market access such as how many dealers might carry United States or foreign products, or how many inspections or regulations are required for imported products before they can get to the dealer, et cetera, rather than specific market shares on an industry-by-industry or product-by-product basis. I do recognize in some cases that might be needed as well. So I strongly support the administration's approach. It would be good for the United States if it works, and good for the world economy.

Let me close by making a couple of brief comments on some of the other points that were made by my colleagues in the panel. First, the argument was made that Japan is already buying as much on a per capita basis as we buy from them. If that was the determining factor of trade flows, we should have a gigantic trade surplus with China, and probably have big trade deficits with everybody else. That is not the way the system works.

In fact, if you turn it around, the Japanese are exporting five times as much per capita to the United States as we export per

capita to them, perhaps, because they dump extensively in the U.S. market. So you can't have it both ways, and I don't think that argument really adds to the issue.

Second, as I talked about earlier, there is also the composition argument, because what they are buying from us are largely commodities and materials, while they are exporting to us presumably high value-added, finished, manufactured goods.

Third, I also discussed the cause-and-effect issue earlier. The major reason for Japan's trade surplus is not their high saving rate. More of it is explained by the fact that they spend a low percentage of what they buy on imported goods. Yes, their thriftiness does contribute to their trade surplus, but more of it is due to their low propensity to import what they buy. That is the key point. And that results from, essentially, a lack of market access for many exporters.

Fourth, the argument was made that the administration's policy will harm U.S. consumers, but what about the production side of the economy? What about the people who are losing jobs because of inability to access the Japanese market? And, what about the excessively strong yen that is resulting from Japanese trade surpluses and closed markets? Doesn't that penalize consumers in the United States? Wouldn't a lower yen and stronger dollar be in the best interest of American consumers? This would likely result if Japan opens their markets.

Fifth, the argument was also made that bilateral trade deficits are unimportant, and generally that is the case. But I don't think you can compare our bilateral trade deficit with Japan to that with Saudi Arabia. It isn't the result of some comparative advantage, whereby the Saudis have cheap oil and we don't; this is the result of closed markets. It does matter, particularly since our trade deficit with Japan is now more than half of our overall trade deficit and because of the composition factor, and because it doesn't change—regardless of exchange rates or whatever else happens. It matters, in my opinion.

Finally, a reference was made to the President's Economic Report. Yes, there was a reference in there that if Japan were to open its markets, it would only result in $9 billion to $18 billion of increased United States exports to Japan. I don't find that insignificant. Furthermore, most other studies show that the effect would be considerably larger than that. So I don't view the administration's economic report as inconsistent with their overall policy.

The bottom line is this: If Japan opens its markets, the United States and the world economy would be better off. The status quo is unacceptable. No other approach that I am aware of will do the job. And, finally, the critics overlook one major fact. The United States, despite our problems, still has the most open market in the world. And to say we shouldn't pressure the Japanese because we are not perfect, misses the essential point.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Chimerine follows:]

# TESTIMONY TO THE SUBCOMMITTEE ON COMMERCE, CONSUMER AND MONETARY AFFAIRS OF THE HOUSE COMMITTEE ON GOVERNMENT OPERATIONS

## U.S. CONGRESS

LAWRENCE CHIMERINE, Ph.D.

VICE PRESIDENT AND CHIEF ECONOMIST,
ECONOMIC STRATEGY INSTITUTE

MARCH 23, 1994

My name is Lawrence Chimerine. I am currently Vice President and Chief Economist of the Economic Strategy Institute. I appreciate the opportunity to testify before the Subcommittee on Commerce, Consumer and Monetary Affairs of the House Committee on Government Operations on the Administration's trade policy toward Japan. My views can be summarized as follows:

- Japan has run large trade surpluses ever since the early 1970s. These have persisted despite
  --major changes in the Japanese economy
  --sharp fluctuations in economic growth rates in the United States and other foreign markets for Japanese goods
  --shifts in exchange rates
  --variations in financial markets
  --numerous bilateral and multilateral negotiations designed to address trade frictions with Japan.

- The Japanese trade imbalance is structural, and results primarily from an extremely low level of manufactured imports relative to other industrialized countries.

- Based on econometric analysis and industry data
  --the shortfall in total Japanese imports exceeds $200 billion annually
  --more than $50 billion would come from the United States
  --the shortfall is not caused by standard economic factors, but by other factors which keep Japanese markets closed
  --Japanese imports are lowest in major Japanese export industries.

- It has become increasingly important that Japan's global trade surplus be reduced because
  --the surplus is depressing economic activity in the United States and other countries
  --it is harmful to high value-added industries in the United States and elsewhere, thus holding down average productivity and wages, research and development, and future economic growth
  --it could lead to even greater trade friction in the future, jeopardizing the global trading system.

- A major opening of Japan's markets to U.S. exports would benefit the U.S. economy by
  --raising U.S. GNP by 1 to 2 percent
  --creating 1.5 million U.S. jobs
  --reducing the trade deficit by $35 billion annually
  --reducing the budget deficit by $35 billion annually
  --raising national savings by 1 percent.

- A substantial restructuring of Japanese markets would also generate benefits for Japan.
  --It would substantially slow inflation.

--Real wages would rise.
--It would lower Japan's extremely high personal saving rate.
--It would prevent potential backlash from other countries that could limit Japanese growth in the future.

- The conventional view that the problem can be solved only by macroeconomic measures is misguided.
  --The problem is structural, not the result of macroeconomic forces.
  --Macroeconomic policies will thus produce only limited trade-related results.
  --These measures would also have major adverse economic side effects.

- Additional U.S. budget deficit reduction would have a negligible effect.
  --It incorrectly assumes that the U.S. trade deficit with Japan is caused by U.S. budget deficits and low saving rates.
  --it does not address the real problem-- namely, Japan's low import ratios.

- Relying primarily on exchange-rate management is inadvisable because
  --the yen would have to double in value to halve Japan's trade surplus
  --it would harm Japan's most efficient industries rather than those that are protected
  --it would create pressure on inflation and interest rates in the United States
  --intervention cannot always influence currency markets.

- The proposed 15 trillion yen economic stimulus package in Japan is needed to fight the current recession, but
  --it would increase Japan's total imports by only about $10 to $28 billion (Japan's 1993 current account surplus was $130 billion.)
  --it would raise U.S. exports to Japan by only $2 to $6 billion (Japan's 1993 bilateral trade surplus with the United States was $60 billion.)
  --it would not raise Japan's unusually low import ratios.

- Efforts aimed at raising Japanese import ratios closer to levels in other OECD countries must therefore accompany macroeconomic measures.
  --Everything else has been tried and failed.
  --The use of objective criteria to measure progress is essential.
  --They do not require market share arrangements.

- As part of the framework negotiations, Japan should agree to the following:
  --a commitment to achieve trading patterns similar to other industrialized countries
  --quantitative measures of openness for specific industries
  --additional deregulation of the economy
  --measures designed to increase foreign direct investment in Japan
  --tax measures to stimulate imports.

- To enhance the chances of success, the U.S. government should

--develop consistent policies and objectives across government agencies designed to penetrate Japanese markets
--work closely with U.S. industry leaders
--improve sectoral analysis capabilities to develop comprehensive export plans
--extend its reach beyond Japanese bureaucrats to industry and political leaders
--encourage Japanese companies to increase their domestic sourcing in transplant operations
--ensure that Japanese firms in the United States operate in accordance with U.S. laws.

The Administration's trade policy toward Japan continues to be attacked by economists and journalists. In my view, many of the arguments against current policy are misleading. The most common ones are listed below.

1. Our trade deficit with Japan is caused by differences in saving and investment patterns, not by Japanese trade barriers. This argument is essentially that the large U.S. trade deficits in the 1980s, both the overall imbalance and the deficit with Japan, were caused by huge U.S. budget deficits and low savings which directly stimulated imports and also created an over-valued dollar on foreign exchange markets. However, this argument is flawed in several ways:

- The United States has had a trade deficit with Japan in every year since 1965, well before the huge budget deficits and declining national savings of the 1980s -- these deficits have been trending upward through the entire period.

- The relationship between saving, investment, and trade is based on the identity S - I = X - M, where S = gross savings, I = domestic private investment, X = exports of goods *and* services, and M = imports of goods *and* services. If U.S. saving is not high enough to finance domestic investment -- if we invest more than we save -- the United States must run a current account deficit (M>X). At most, however, savings and investment patterns relate to overall trade balances, not the bilateral balance between the United States and Japan, and thus cannot explain the magnitude or persistence of our trade imbalance with Japan.

- Even on an overall basis, causality in the savings less investment equals the current account imbalance identity can run in both directions. Thus, measures which open Japan's market, or other exogenous factors which increase U.S. exports, can increase national savings because of the higher incomes that would result, keeping the identity in balance.

- There is virtually no correlation between the Japanese trade position and national savings across countries--in fact, Japan runs trade surpluses with virtually every country, including some with high national saving rates and some with low national saving rates.

- Only about a fifth of the difference in the ratio of imports of manufactured goods to GDP between the United States and Japan can be explained by differences in their national saving rates--most is explained by differences in the propensity to import. Thus, Japan's imports are low not because they save so much, but because they import a relatively small share of what they buy.

- One reason why the Japanese personal saving rate is so high is because of the lack of access to imported goods. This reduces the range of goods and services available to consumers, and also pushes up prices of consumer goods and services--both discourage consumption. Thus, Japan's high saving rate may in part be an outgrowth of the structural barriers which have kept imports down and helped create their huge trade surpluses, rather than the other way around.

The bottom line is that as long as there is excess capacity in the United States and in other countries, a reduction in Japanese trade barriers which increases Japanese imports will stimulate the economies of the United States and other exporters. In so doing, it will create jobs and produce higher incomes and government revenues. This same argument was made numerous times during the NAFTA debate--it was argued that the opening of Mexico's markets would increase U.S. exports, thereby creating enough new jobs to more than offset the jobs that would be lost by the shifting of production facilities to Mexico. This in no way contradicts the existence of the now-famous accounting identity, nor the fact that policies which change U.S. budget deficits or savings will impact trade flows.

2. Bilateral trade deficits don't matter anyway. Under normal conditions, this argument would be relevant, but the case of Japan is not typical.

- Our bilateral deficit with Japan requires special attention because it accounts for more than half of our overall trade imbalance.

- Our bilateral deficit with Japan has been completely resistant to changing economic conditions, such as shifts in exchange rates, changes in relative economic growth, etc.

- The composition of our trade with Japan is extremely unfavorable for the United States -- they buy primarily low value-added commodities from us but the U.S. imports primarily high value-added manufacturing goods from them. This holds down overall investment, research and development spending, average wages, etc. in the U.S., and is thus not healthy for long-term economic growth.

- The United States is not the only country to run trade deficits with Japan on a regular basis--most other countries do as well.

In sum, the theory that bilateral trade deficits don't matter is based on the assumptions that they are not caused by structural factors; they will vary over time; and that trade patterns

for any country will vary across its trading partners. These do not hold with respect to Japan.

3. Even if all Japanese trade barriers were removed, U.S. exports to Japan would only increase by $9-18 billion dollars. This estimate was derived from a study done by Mark Noland (now on the CEA staff). However, we believe that it understates the extent of Japan's import shortfall for the following reasons:

- The data in the study was based on only 112 tradable goods, a number well below the potential range of goods and services which can be exported to Japan.

- The estimate takes into account only the impact of higher prices caused by Japanese import barriers on the demand for imports-- it does not take into account the fact that many of those barriers keep imports out completely.

- Based on standard statistical measures, the reliability and predictive power of the Noland model is highly questionable.

- Other studies have estimated that the shortfall in Japan's imports is much larger.

4. Macroeconomic policies are the appropriate solution for the U.S.-Japan trade imbalance. This is an extension of the saving and investment argument discussed earlier, which leads to the conclusion that a big stimulus package in Japan, coupled with additional deficit reduction in the United States, will greatly reduce or eliminate the imbalance.

- However, additional U.S. deficit reduction is the wrong approach.

• The U.S. budget deficit has fallen in half in the last few years, but our trade imbalance is rising again. In addition, during the second half of the 1980s, when the overall U.S. trade deficit did decline sharply in response to a weaker dollar, our trade deficit with Japan hardly came down at all.

• A two percent tax increase in the United States would reduce the federal budget deficit by more than 50 percent, but would reduce our imports from Japan, and thus our bilateral trade imbalance, by only $5 billion.

• It doesn't address the real issue, namely the low propensity to import in Japan.

• In the short run, it would undercut the economic recovery that has finally developed after years of stagnation.

- The proposed economic stimulus package in Japan is needed to fight the current recession but:

- It would raise Japan's overall imports by $10 - 20 billion, but it would not significantly increase Japan's import to consumption ratios.

- It would increase Japan's imports from the United States by only $2-4 billion, thus leaving most of the existing imbalance in place.

5. Let exchange rates solve the problem. We believe that this is a poor approach, for the following reasons:

- It is difficult to manage exchange rates because they are increasingly determined by differentials in interest rates and other factors which affect capital flows. In fact, it is likely that the yen will weaken somewhat if U.S. interest rates continue to rise and if Japan cuts its rates.

- Even if the yen were to strengthen, the side effects would not be in the best interests of both countries.

- Because the relevant elasticities are so small, the dollar would have to fall to 50-60 yen to halve Japan's trade surplus.

- It would penalize the most efficient industries in Japan, rather than those that are now being protected by cartels and other protective measures.

- It would create upward pressure on inflation and interest rates in the United States.

In our view, a stronger yen is now desirable primarily to increase the pressure on the Japanese to adopt market opening measures and to enact a large stimulus package as soon as possible, but not as a direct solution to the trade imbalance.

6. U.S. trade sanctions will trigger a trade war with Japan. The problem with this argument is that it assumes that the status quo is acceptable -- this is clearly not the case. Japan is currently exporting unemployment to the rest of the world, including the United States. Furthermore:

- As indicated by the huge amount of trade friction in recent years, and the near thirty rounds of negotiations with the Japanese over the last fifteen years, there is already a trade war with Japan which, if not addressed, could get worse in the years ahead.

- The Japanese are still highly dependent on the U.S. market, especially now that domestic demand in Japan is so weak, so major trade sanctions in retaliation over U.S. sanctions are unlikely.

7. A strong yen will hurt the U.S. economy. Some commentators are criticizing the administration for hinting that it would favor a stronger yen. Their train of logic is essentially that a stronger yen will weaken Japanese exports, aggravating the current recession in Japan, and in so doing will reduce Japanese imports from the United States and elsewhere. Thus, U.S. trade with Japan, and U.S. economic activity, would on balance be adversely affected by yen appreciation. However, the decline in Japanese GDP and incomes from yen appreciation would be relatively small (.5% at most). Given the relative low income elasticity of demand for U.S. imports in Japan, that this will reduce U.S. exports to Japan by only $500 - 700 million. The direct effect of exchange rates on U.S. exports to Japan would exceed that, so the net impact would be somewhat positive for the U.S..

8. Let the GATT resolve the dispute. Unfortunately, this is not a viable approach because:

- There is no dispute resolution body within the GATT currently in place to address the trade practices that Japan employs to keep its markets closed.

- These practices were not even included in the Uruguay Round agenda. The Uruguay Round agreement may make it more difficult for us to get more favorable rulings on these issues in the future.

9. The U.S. position amounts to managed trade. The U.S. has insisted only on quantitative measures of market openness, and not on market shares for individual products, or on a targeted trade balance, or on any other measure of actual outcomes. This is also hypocritical since Japan's trading practices have been violating the principals of free trade for decades, whereas the United States has been the most open market.

10. Japan is buying a lot from the United States -- they are in fact our second biggest export market. This is misleading for the following reasons:

- Japan is the second largest economy outside the United States, and thus should be expected to buy a significant amount of U.S. produced goods and services.

- Raw materials and agricultural products make up nearly one third of Japan's imports from the United States -- Japan must import these goods because they are resource-poor.

- U.S. penetration of the Japanese market for virtually every manufactured good is far less than in virtually every other industrialized country.

11. On a per capita basis, Japan imports as much from the U.S. as the U.S. imports from Japan. This is a variation of the argument discussed above. While technically correct, it is very misleading.

- Because the U.S. is so large, it can produce a wider range of goods than less populated countries and should be importing less on a per capita basis than most other countries, including Japan.

- Taking the argument to it's logical conclusion, if U.S. per capita imports from every country in the world equaled the per capita imports of every country from the United States, the United States would be running trade deficits with all less populated countries and a huge trade surplus with China.

- Turning the argument around, Japan's per capita exports to the United States totaled $743, but U.S. per capita exports to Japan were only $182.

Mr. SPRATT. Thank you very much, Mr. Chimerine.

Mr. Saxonhouse, you say in your testimony with some indignation that one of the things our government is demanding is changes in Japanese domestic regulations and tax provisions. If these tax provisions——

Mr. SAXONHOUSE. It's not my testimony.

Mr. SPRATT. I beg your pardon.

Dr. Niskanen, then, you say that. If these regulations and provisions discriminate against American products, restrict or make more difficult access to Japanese markets, No. 1, what is wrong with our seeking a change in them in a sense of fairness? And, No. 2, why not do it directly in bilateral negotiations as opposed to going through the World Trade Organization, which doesn't exist yet, and relying on GATT, which may or may not have a legal solution to the problem?

Mr. NISKANEN. Two matters, Mr. Chairman. One is the issue is whether these regulations and taxes specifically discriminate against American products or the nature of the regulations and taxes may have the effect of discriminating.

For example, on the inspection procedures on cars, the Japanese for many years have had one inspection procedure for low-volume cars and another inspection procedure for high-volume cars. American cars in Japan have never achieved a volume that would make it possible to get class inspection. And low-volume cars, they treat all foreign low-volume cars the same; they treat foreign high-volume cars the same. But we have never had the volume level of sales in Japan that would achieve the class inspection procedure.

Now, the Japanese in recent days have made the Jeep Cherokee eligible for the class inspection procedure. I think that is a special exception, in fact, because it doesn't meet the volume that they usually require. So that is an example of where the nature of their regulations has the effect of discriminating against American products, but it is not specifically discriminating against American products. It treats all low-volume cars the same at the inspection level. Much the same thing about various tax provisions.

Mr. SPRATT. Well, if I could interrupt you there. If it has that effect, that demonstrated effect, and if they have this substantial bilateral trade deficit with us which is persistent, it hasn't responded to the macroeconomic changes significantly, then why not go after the effect? Even if it is not patently discriminatory, this is one problem. Why not go to the source of the problem and deal with it? It doesn't require a lot of——

Mr. NISKANEN. Well, two issues. One is that the trade deficit has been substantially variable as a function of macro conditions. And at the moment it is unusually large because we are in a moderate recovery, and the Japanese are in a severe recession. Our overall trade deficit fell very sharply at other times under different macro conditions.

Second, the appropriateness of an action is a function not of whether the goal is commendable, but whether the act itself, whether the tactic that we use is authorized by a prior agreement. If it is not authorized by a prior agreement, it is strictly bullying.

If we don't happen to like the outcome of an action and we say, "The results are not satisfactory to us and so you've got to do some-

thing, or we are going to bash you," that is an inappropriate action whatever the goal, even if the goal is most commendable.

Open markets are fine. I have been campaigning for open markets in the United States and in other countries for decades. But open markets by gunboats, the way we did with Commodore Perry? Open markets by trade sanctions that have no legitimacy on the basis of an existing agreement between the United States and Japan, either as a bilateral basis or a multilateral basis? An action has to be judged on whether the action itself is legitimate, not whether the goal is in some sense a commendable goal.

The U.S. Government has yet to charge Japan with a violation of these 30 or so agreements that we have with them. They have charged Japan that the agreements have not led to the outcomes that American parties have liked. But even in this Motorola case, for example, they did not charge Japan with a breach of the prior agreements in cellular telephones. What they said is that Motorola didn't get the sales and the Tokyo-Nagoya Corridor that they had hoped, so we put pressure on them. That is an inappropriate action.

Mr. SPRATT. You've got some questions? Do you want to go vote and then come back?

Mr. COX. Yes.

Mr. SPRATT. OK, fine. I will continue the hearing while he is voting.

I was at the Shimotu conference several years ago, and a professor of ethics, I believe, or philosophy at least at Kyoto University, and I were discussing what was to become Super 301, the Gephardt amendment, trade bill. He suggested that our philosophical approach was wrong, that we should not characterize the Japanese or their economy as being unfair, that the Japanese regarded themselves as efficient and diligent and hardworking and thrifty, and to call them unfair for doing what they regarded as virtuous would not sit well with the Japanese.

Instead, he said that we should explain to them what they would understand best. As a country that has lived for years, understanding implicitly as well as any country in the world export-led economic policies, they would understand if we explained to them why we had to have a rectification of our balance of payments. Because they have practiced these policies themselves and instilled the belief and understanding in their population.

Lester Thoreau had another slant on it. He said, "It is less imperious and less intrusive of us to couch our objectives in the same terms we would like to have these results," and then to say to the Japanese:

> You work out the means, these are the ends. And you can understand these ends, because if you were in the same situation you would have the same objectives. But we will leave to you internally, within your country, how to rework your distributional networks, how to work out the problems with MITI institutionally. Whatever the problem may be, we will leave it up to you. But we want to seek these ends and we want a process for periodically reviewing it.

That's not bullying, that's not gun boat diplomacy, and it's not couched in language that the Japanese themselves shouldn't be able to understand. What's wrong with that?

Mr. NISKANEN. I think it's wholly appropriate for American officials to tell the Japanese that there are a variety of practices in Japan that we would like to have changed. The issue is what we do if they don't do it. You know, Japanese products are expensive in Japan. That was the biggest surprise when I first visited Japan is that you can buy Japanese cameras in New York or Washington cheaper than you can in Japan.

The Japanese retail or distribution system is terribly inefficient. That has the effect of making American products quite expensive in Japan. It also has the effect of making Japanese products quite expensive in Japan. I think that friends ought to convey to each other attributes of the other party's behavior that they would like to talk about.

The issue is what you do if they say, "Well, that's who I am." The issue is, again, not whether the Japanese in their own interests as well as ours ought to change their distribution system. I think that if I were a Japanese I would be very concerned about the distribution system over there. It is terribly inefficient and very, very expensive.

Mr. SPRATT. Well, what is wrong with our being concerned as well if it prevents us from gaining access?

Mr. NISKANEN. Fine, fine, let's do that, let's tell them that. Let's suggest that both in their interest and in our interest they ought to change their distribution system. The issue is what we do if they don't do it. The issue is the threat or the sanction that we impose.

Now, if in addition we conducted our relationships with Japan the way that we do in regional and multilateral arrangements, these are an exchange of concessions in those arrangements: "You give us something that we want, we will give you something you want."

The nature of our relationships with Japan has all too often been quite different. It has been that of a bully rather than that of the trader. It has been that of saying, "You do something that I want, or I will do something you don't want." That is a very different response. And it is that kind of behavior that undermines the rule of law.

Mr. SPRATT. Mr. Chimerine.

Mr. CHIMERINE. Thank you, Mr. Chairman. Just a couple of very brief comments. First, I think you put your finger on the essence of the issue a couple of moments ago. It seems to me that this problem will never get solved unless there are changes made in the economic structure in Japan, especially in the distribution system and the keiretsu system. This is a structural, chronic trade surplus and only structural change will address it, or provide the bulk of the solution.

The issue really is, will quantitative targets of some sort be useful in monitoring progress that Japan makes toward changing its structure? I think that is the biggest reason for targets. Because without goals to aim for, and without something to monitor progress, in my opinion these changes are not likely to take place.

I think the Japanese should be very comfortable with this approval. They use quantitative targets internally in their economic management. They are very comfortable with setting goals and try-

ing to reach these quantitative targets. So this is not something foreign to the Japanese.

The second point is that when you look back historically at some of the previous negotiations, and I've not studied them all, but it seems to me we have been sort of lecturing the Japanese, "You shouldn't run your economy this way. You should have stronger antitrust laws, and you should do this or you should do that."

The Japanese have the right to run their economy any way they want. But if it creates competitive problems, or a lack of market access, we have to take some steps to overcome that. That is what this is all about.

I don't agree with the view that if they don't respond, "Well, we shouldn't bully them." What else are we going to do? It's either a matter of accepting the status quo, or implementing some actions or sanctions so that we can put this more on an equal basis; I favor the latter. I have a hard time understanding, "Well, they may be wrong and we ought to tell them how to change. But if they don't do it, well, that's the way it is."

Mr. NISKANEN. Well, Larry starts from a position that I do not share; and that is the position that the big Japanese trade surplus is a problem. The Japanese trade surplus means that they are sending us more goods and services than we send them. It's not at all clear why that is a problem.

It means that they are lending more to the rest of the world, in a capital-short world, than they are borrowing from the rest of the world. That doesn't look like a problem to me. Particularly with our extraordinarily low saving rate, it doesn't look like a problem the Japanese is a big net lender to the world.

Mr. SPRATT. It means that we become a debtor and they become a creditor, and that in the long term becomes a problem.

Mr. NISKANEN. That is a problem, however, in which they, in effect, have loaned us money because we have been profligate. Now, is the problem attributable to the person who loans us money, or is the problem the fact that we have been profligate? Our private saving rate has plummeted and our Federal deficit is still very high.

The problem is at home and in this building that has lead to tax provisions that are biased against savings and a fiscal policy over a 15-year period that has been irresponsible. I was part of that in the Reagan administration, and I acknowledge that.

Mr. SPRATT. Mr. Saxonhouse.

Mr. SAXONHOUSE. Related to what Bill says, I wanted to point out that at the moment the Japanese trade surplus is not a significant factor in the determination of U.S. employment rates and levels. If you are worried about jobs in the United States right now, you should be talking to Alan Greenspan. Increases in the interest rates in the United States have more to do with the level of unemployment and the structure of jobs in this country than anything American trade negotiators could do for the next 30 years. We are losing focus.

Mr. SPRATT. We stipulate that. You can go on with that. I'll grant you that.

Mr. SAXONHOUSE. We are really losing focus in thinking about trade as an unemployment issue. It is not a jobs issue to any large

degree. It has something to do with American industrial structure and with Japanese industrial structure. It doesn't have much to do, however, with the volume of employment.

Mr. SPRATT. Let me suggest two realms in which it does have a bearing on jobs. No. 1, we have a somewhat spotty recovery. If you don't believe it, come from Ann Arbor to South Carolina, and I'll take you to the rural parts of my district, which are in striking contrast to the metropolitan part.

I've got double-digit unemployment in half the counties I represent. Structural unemployment layered with cyclical unemployment, the delayed recovery—it still hasn't happened yet. We've still got a jobs problem. In a little county south of the county I represent, 853 jobs have gone to Malaysia. It will be a long time before they replace jobs like that.

Mr. SAXONHOUSE. Mr. Chairman, do you think it is more effective for you to talk to Prime Minister Hosokowa or to Chairman Greenspan about that issue?

Mr. SPRATT. Well, I would talk to both of them. Because I think the Japanese trade balance is part of the problem. In addition to that, if you look at real wages in this country since the early 1970's and the development of industrial jobs in this country, you have to be worried about our retention of value-added jobs and the orientation of our industrial development in this country. And so we want to export as much as possible of our high value-added manufacturing products.

Mr. SAXONHOUSE. Mr. Chairman, the economics profession has done some very careful studies recently, particularly a study by Paul Krugman and Robert Lawrence. I don't always agree with either of them on all issues, but I certainly agree with them on this one. Trade has had only the smallest impact on the level of real wages in this country. Neither growing imports nor a growing trade deficit are responsible for the failure of real wages to grow in this country over the past 20 years.

Mr. SPRATT. Mr. Chimerine.

Mr. CHIMERINE. Yes, Mr. Chairman, I obviously agree with some of your comments, but I would like to make two points. First, I think it is premature, to reach the conclusion that there is little impact from trade patterns on wages and living standards in the United States, although I fully agree that the biggest factor is slow productivity growth in the United States. But the composition of trade and the adverse impact of trade deficits on investment, on average wages, and on average productivity could also be a factor, a smaller one but nonetheless a factor in the stagnation of average wages.

Second, I mean, we make it seem as if we run a $20 billion, or $40 billion, or $100 billion, or $200 billion trade deficit, we can overcome it with fiscal and monetary policy. But, first of all, we have a $180 billion or $200 billion budget deficit. We fought in this chamber last year about whether to have a $16 billion stimulus package, which we didn't get.

Mr. NISKANEN. Fortunately.

Mr. CHIMERINE. Well, Bill says "fortunately." But perhaps we could get that by opening Japan's markets.

Let me just make one other point, Gary.

Second, the Fed's ability to control the economy is also not perfect. We want the Fed to pursue policies that are in the best interest of the U.S. economy, by balancing growth with inflation. But the bottom line is still this. The evidence overwhelmingly suggests that if the Japanese were to open their markets, particularly if you believe as I do that there is an issue of market access, this would lead to an increase in imports from the United States and elsewhere, the United States and global economies would be better off. That is the bottom line.

Mr. SPRATT. Do either of you really dispute that proposition, that if the Japanese were to increase their imports from the United States and we were to diminish our bilateral balance with them and our overall trade balance, that the world economy and ours as well would be in better shape?

Mr. SAXONHOUSE. Let me be very careful here. Japan does have trade barriers—there's no question about it—and it has significant trade barriers. The question is whether these barriers are significantly more restrictive than those of other countries. The evidence on the part of a large number of studies that have been done is by no means overwhelmingly in favor of this hypothesis. There are, in fact, more studies that show that Japan's trade barriers are rather similar to what trade barriers are in other countries in their impact than are studies showing that Japan's trade barriers are wildly out of proportion.

The quotes I made from the "Economic Report of the President" I think are well considered. I don't think they were intentional on the part of the Clinton administration, but they are there nonetheless. One item that you might want to look at, Larry has talked about, that is the marginal propensity to import. Larry says it quite differently between Japan and other countries. I wonder. You should recognize, however, that imports, total imports, as a proportion of gross domestic product are the same in Japan as in the United States, as in the European Union. They are all somewhere between——

Mr. SPRATT. But you have to look at composition, the manufacturing imports are 3.1 percent of GNP in Japan, and they are close to 7 percent in this country.

Mr. SAXONHOUSE. That's quite correct. But notice, Mr. Chairman, that if were you to look at the natural resource composition, were you to look at the amount of arable land in Japan, were you to look at the amount of oil, were you to look at the various other kinds of mineral deposits that exist in Japan, they would look just as unusually low as does that relatively small 3.1 percent.

I should also point out that manufactured imports as a percentage of GDP being 3.1 percent while it looks low, it has been rising over the past decade. We used to talk about this ratio being constant at 2 percent. Now we talk about it settling at 3.1 percent. In fact, it had gone as high as 3.7 percent before the recession took over.

Mr. SPRATT. I am waiting on Mr. Cox to return, because I think he had some specific questions to put to all of you.

Mr. SAXONHOUSE. I have a plane to catch.

Mr. CHIMERINE. I can wait, Mr. Chairman.

Mr. SPRATT. OK. Hold on just a minute and let's confirm whether or not he is going to return. I thought when he left he was coming back.

Do you know if Chris Cox is coming back? Do you know if he is coming back?

A PARTICIPANT. I don't know.

Mr. SPRATT. OK, fine. Can you get his office?

Mr. CHIMERINE. What is the vote on, Mr. Chairman? Do you know?

Mr. SPRATT. I don't know. I just missed it though so——

Mr. NISKANEN. Mr Chairman, on the jobs trade deficit issue, you should recognize that the cyclical relationship there is negative. We have trade deficits typically when our unemployment rate is lowest. The trade deficit goes up with economic recovery and goes down with recessions primarily because investment is more cyclical than savings.

When we have a recovery, our investment increases relative to our savings. That increases our trade deficit at the same time that recovery reduces our unemployment rate. So at least on a cyclical basis, the relationship between trade deficits and unemployment is negative, not positive.

Mr. CHIMERINE. But this is a structural problem.

Mr. SAXONHOUSE. That's true for every country.

Mr. NISKANEN. We have been profligate.

Mr. CHIMERINE. The point has been made several times this morning that we're in a recovery now, and Japan is in recession, and that accounts for the bulk of the trade deficit with the Japanese. But, 2 years ago, the situation was reversed. We were in the midst of a long stagnation and the Japan economy was booming, and the size of these deficits were fairly similar—I don't think you can conclude that this is a short-term cyclical phenomenon, based on the pattern over a long period of time.

Mr. SPRATT. Let me turn it over to Chris Cox, then. Mr. Cox.

Mr. NISKANEN. Mr. Chairman, may I just finish one point that you had asked me about? You should realize that when imports go into Japan, if the savings and investment relationships don't change, more exports go out of Japan. So people who believe that imports are kept way down in Japan should also believe that exports are, perhaps, lower than they ought to be.

Mr. CHIMERINE. Can I comment?

Mr. COX. Mr. Chairman, are you planning on returning?

Mr. NISKANEN. He's gone.

Mr. CHIMERINE. I think he is gone.

Mr. COX [presiding]. It matters. He must, I take it, be planning on returning, in which case I would urge you to talk to him when he returns, because he really does need to go over there for the vote.

I would like to return to a point that was discussed before I left for the vote, and that was the differing views offered on the materiality or not of the fact that Japan buys more from the United States per capita than does the United States buy from Japan. I am told, on the one hand, this is relevant; and, on the other hand, it's not relevant. Facially, it strikes me as extremely relevant.

I know we can't resolve it in the sense that all three of you will end up agreeing, but maybe we can sharpen the difference so that we understand why we disagree about it.

Mr. NISKANEN. My sense, Representative Cox, is that it is relevant but not conclusive. It is an indication of the fact that the Japanese, in fact, buy a lot of American products. And if you include the products that they identified as American but are produced by American companies outside of the United States, they would buy a huge amount of American products. It is not by itself sufficient evidence on how open their economy is; it is just an indication.

The Japanese economy is much like a maze. The outer gates to that maze now are quite open. Their average tariffs are lower than ours and the range of products covered by quantitative limits is lower than ours. The inner gates to that maze are a consequence, in part, of longstanding business practices and archaic distribution systems and all of that.

I think the issue is how, not whether, but how we deal with the Japanese to try to convince them that it is in both their interests and our interests if they change some of these internal domestic regulations and business practices. From my point of view, the key there is whether we do it by pressure or by trading, and whether we do it on a unilateral basis or whether we do it as part of more general trade arrangements.

Mr. CHIMERINE. Yes, Congressman, I made reference to that point earlier. I guess I would agree with Bill; it is something to look at but it is far from conclusive. In fact, by that measure the Japanese are exporting almost five times as much per capita to the United States as the United States exports per capita to Japan. Trade has never been balanced this way.

[Further explanation of bilateral per capita import figures is in appendix 2.]

Mr. CHIMERINE. If we use this as a standard, as I said earlier, we should be running a multibillion dollar surplus with China on a regular basis, and big trade deficits with all the smaller companies. It is not a measure of trade patterns that I think has significant meaning. In fact, I think a more——

Mr. COX. Well, it wasn't clear to me that that follows perforce.

Mr. CHIMERINE. Excuse me?

Mr. COX. It isn't clear to me that it follows perforce that we must need to have a trade surplus with the People's Republic of China, I take it you mean. Rather, it simply goes to the fact that as we criticize someone for not buying enough of our products, we need to take into account that in the matter of mutual advantage we should consider what we buy from them.

Mr. CHIMERINE. Oh, I agree but——

Mr. COX. That strikes me as perhaps a more logical rather than statistical measurement but, nonetheless, one of some relevance.

Mr. CHIMERINE. Well, let me make the point a slightly different way. For virtually every manufactured product that the U.S. exports, our penetration of the Japanese market is significantly less than it is in virtually every other industrialized country.

Starting with cars and a whole range of U.S. manufactured goods, even chemicals, we have a smaller fraction of the Japanese

market than anywhere else, despite the fact that the numbers happen to work out that on a per capita basis their total imports are roughly the same as ours.

The second part of that argument is that a lot of what we sell to Japan, as mentioned earlier, are grains, commodities, and wood chips. It is the composition argument. They are selling us much more high value-added manufactured products, which are the ones that have been most difficult for us to sell in their markets.

Mr. COX. I know that Mr. Saxonhouse deserves an opportunity to respond on this one point. Before you do, let me take the liberty of adding to it this much. If Japan is an island nation that's incredibly productive, if they are going to be successful, doesn't it make sense if they are an island nation and they are going to export, that they would, by and large, want to be in manufacturing as services as against raw materials?

Mr. CHIMERINE. Yes, but that doesn't justify——

Mr. COX. Can we change the geography of Japan?

Mr. CHIMERINE [continuing]. Keeping their markets closed to imports. I'm not complaining about Japan's export patterns.

Mr. COX. I'm talking about the compositional argument now.

Mr. CHIMERINE. Yes, to some extent, the composition won't balance, or won't exactly balance. But the point is that the imbalance is so large and that it results to a great extent from lack of access of foreigners to their markets. That's the point.

Mr. COX. Mr. Saxonhouse.

Mr. SAXONHOUSE. Well, I think the moment has passed for that particular point. I would say, in general, you would expect that a country which has Japan's natural resource endowment would have a very large surplus in manufacturers. It wouldn't necessarily mean they would have a trade surplus. On the other hand, a country that is highly thrifty, you would expect to have a trade surplus.

Mr. COX. The reason these things are important, I think, is that we don't want to say that because Japan is closing its markets these things follow perforce as if the obverse would be true, which is to say that if Japan didn't close its markets at all, that they wouldn't have a trade surplus, the composition would be different, or what have you. I want to make sure that I understand, in particular, whether you are suggesting that.

Mr. CHIMERINE. Oh, no. The focus, I think, has to be on market access, not on any specific outcome with respect to the trade surplus or any other measure of trade. The issue, in my view, is market access.

Mr. COX. All right. And that seems to me to then lay the foundation for distinguishing in our negotiations between our levers to open markets, on the one hand, and so-called objective measurements, on the other hand. Because if we objectively measure, what we are seeking to do is apply some normative standard that there should or shouldn't be a trade surplus of X, Y, or Z size, then we are making a mistaken. But would you agree with that?

Mr. CHIMERINE. Absolutely. I think the administration's approach of focusing primarily on measures of market opening and market access, and using quantitative measures on which to measure progress, is the right approach. I am not advocating individual product-by-product market shares, or industry-by-industry shares,

or a specific targeted trade surplus. I think measures of market access are completely appropriate, however.

Mr. NISKANEN. Mr. Cox, let me make a point here. The Japanese feel that they were blindsided by our interpretation of the semiconductor agreement. In a side letter to the agreement, not in the basic text, one of their ministers suggested that these measures might lead to a 20-percent foreign market share of the Japanese semiconductor market.

We took that, or our officials took that, as a commitment and were prepared and did implement sanctions because at least for the short period of time it did not reach the 20 percent. Our officials somehow regard that agreement as a great success and want it to be a model for the future. The Japanese regard that agreement as being an example of something they should never ever do again.

It is in part because we interpreted that side letter as, in effect, part of a basic text and as a commitment by the government; they interpreted it as a gesture of what might happen if these measures were taken. And they will resist, I predict they will resist quantitative measures of any kind because of our track record of interpreting these measures as targets or commitments.

Mr. COX. Mr. Saxonhouse.

Mr. SAXONHOUSE. Yes. Well, related to that, I think it's not simply the interpretation, though, I think that's an important point, but also their inability to deliver. They have gone a long way toward deregulating their economy. Their economy was never as regulated as many people made it out to be, and they simply don't have the levers to deliver market share up to American firms.

The semiconductor agreement was an absolute disaster. They spent hours and hours dealing with hundreds and hundreds of firms reviewing plans for purchasing. It was a totally unworkable arrangement, and one I think that they vowed never to get into again. I think that, in part, explains their reluctance.

Also, I think the standards that are often used to argue what is an appropriate share, why the Japanese ought to be subjected to this, are extremely one sided. It's said that the United States has a larger market share in Third World markets than it does in Japan, and that is evidence of Japanese discrimination. Well, I want to point out that in many, many markets—in many, many Third World markets—Japan has larger market share than it does in the United States.

Now, Mr. Chairman, does that mean that the United States is discriminating against Japan? Not necessarily. It simply means that both the United States and Japan are countries that have great strength in manufactured products and that domestic purchasers for reasons of convenience, familiarity, et cetera, tend to go for their own domestic supplier. There is nothing illegal or incorrect about that at all.

Mr. COX. Will you provide an example of a country in which that circumstance pertains?

Mr. SAXONHOUSE. Well, I can talk about the semiconductor market. The data of the Semiconductor Industry Association itself shows that in Third World markets Japan has a larger share than it does in the American market. That is data that I think nobody is disputing.

Mr. CHIMERINE. Can I make a comment on that?

Mr. COX. Yes. And I would like to thank Dr. Niskanen for being with us.

Mr. CHIMERINE. I think Gary is right in selective cases, but he is clearly not correct across the board.

Mr. COX. Mr. Saxonhouse, are you staying with us?

Mr. SAXONHOUSE. No, I have to leave, unfortunately.

Mr. COX. All right.

Mr. CHIMERINE. Well, can I just make one final comment?

Mr. COX. Oh, by all means, of course.

Mr. CHIMERINE. I think Gary's point is right in some cases, but it is not pervasive across the board. In fact, in most cases, Japan has a higher share of the United States market than it has in most other overseas markets. This is the opposite of what our situation is with Japan.

Second, I have a lot of confidence in Japanese consumers. I think the evidence shows that when foreign products are available and accessible to consumers in Japan, at reasonable prices, they will buy them.

So I am not asking for specific market shares, all we are asking for is that they have access to those products. I think that will not only result in more purchases of imported goods, but, second, it will probably bring their saving rate down because in my opinion, one of the reasons their saving rate is so high is because of the high prices of both imported and domestic goods, in part because of the lack of competition from lower priced imports.

So I don't think anybody can make a reasonable argument against market access in Japan. It seems to me it boils down to, how do you bring it about? And many of the opponents sort of agree, "Yeah, market access would be good. But if the Japanese don't go along, well, we don't know. You know, so what?" I don't think that is the appropriate attitude, and I guess that seems to be the major difference here.

Mr. COX. It has been suggested by our other two panelists that our policy of negotiation ought to comprise both carrots and sticks. There was not any theoretical objection to that from any of the administration witnesses, although I will have to go back and doublecheck the record to see whether there was any specific carrot that was, in fact, being offered.

I mentioned at the conclusion of that panel's testimony and the questioning that I would wish them to consider offering Japan the opportunity to purchase Alaskan North Slope crude. That's something that would be of great significance to Japan. What do you think about that?

Mr. CHIMERINE. Congressman, that's an interesting question, and that issue has surfaced from time to time in recent years. To be honest, I did look at it carefully a number of years ago, but I really haven't been on top of it recently. Off the top of my head, it seems to make some sense.

I really don't know all the ramifications of it, but it certainly should be explored. Again, I doubt very much if this is going to come anywhere near close to making a big dent in our bilateral trade deficit with Japan, but it certainly should be looked at.

Mr. Cox. Well, I certainly appreciate your testimony today, and that of the two witnesses who were formerly on your panel. [Laughter.]

I think that we have done as much as we can this afternoon, and I appreciate in particular your spending so much time here.

In the authority of the Chair that the chairman almost gave me, I will adjourn the hearing with the gavel. Thanks very much.

[Whereupon, at 1:35 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

# APPENDIXES

## APPENDIX 1.—JOINT STATEMENT SUBMITTED FOR THE RECORD BY U.S. MOTOR VEHICLE PARTS ASSOCIATIONS

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Charles R. Blum, President

April 5, 1994

The Honorable John M. Spratt
U.S. House of Representatives
1536 Longworth House Office Building
Washington, DC 20515-4005

Dear Congressman Spratt.

The following statement regarding U.S.-Japan automotive trade is submitted on behalf of seven major associations representing a very broad cross-section of the U.S. motor vehicle parts manufacturing, parts distribution and independent vehicle service industries.

This statement highlights the strong unified position of our associations in support of the Administration's ongoing efforts to conclude a results-oriented trade agreement with Japan on issues of concern to the U.S. automotive industry. We have reviewed recent Japanese government and industry announcements concerning planned future steps to promote increased Japanese purchases of U.S. automotive products.

We concur with the Administration's view that the Japanese government's proposals fall well short of the market access and deregulation goals set forth by U.S. industry in the U.S.-Japan Framework negotiations Further, we believe Japanese vehicle manufacturers' plans represent an important, but modest statement of intent to expand business with U.S. suppliers in the United States and Japan.

On balance, these plans appear insufficient in view of the strong international competitiveness and Japanese business development efforts of U.S. automotive suppliers, prevailing yen/dollar exchange rates, and rising Japanese vehicle assembly capacity in the United States Changes in Japanese industry business practices and goverment policies are keys to reducing the massive and persistent U.S automotive parts trade deficit with Japan, and ensuring a healthy American automotive industry

We ask that you review our statement and work with us and the Clinton Administration to encourage Japanese government and industry to take appropriate steps to allow fruitful U.S.-Japanese trade talks to resume. Please contact us if you have any questions concerning our views or would like additional information

Sincerely,

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# JOINT U.S. AUTOMOTIVE ASSOCIATION STATEMENT ON U.S. - JAPAN AUTOMOTIVE PARTS TRADE

Prepared by

Automotive Engine Rebuilders Association

Automotive Parts Rebuilders Association

Automotive Service Association

Automotive Service Industry Association

Automotive Warehouse Distributors Association

Motor & Equipment Manufacturers Assoc.

Specialty Equipment Market Association

## JOINT U.S. AUTOMOTIVE ASSOCIATION STATEMENT ON U.S.-JAPAN AUTOMOTIVE PARTS TRADE

**April 5, 1994**

- Our seven U.S. associations, representing a very broad cross-section of the U.S. automotive parts industry, today reaffirm their strong support for President Clinton's decision to discontinue trade talks with Japan when it became apparent that meaningful, results-oriented agreements could not be reached in the automotive and other areas of the U.S.-Japan Framework negotiations. We continue to hope that Japanese industry and government will take appropriate steps to allow fruitful U.S.-Japanese trade talks to resume.

- Last week, Japanese vehicle manufacturers announced international cooperation plans establishing new company-specific targets for increased purchases from U.S. automotive suppliers. The Japanese government also released a new action plan to promote increased imports.

- On balance, our associations believe the Japanese company plans represent an important, but modest Japanese industry statement of intent to expand business with U.S. suppliers in the United States and Japan. The plans appear insufficient in view of the U.S. automotive supplier industry's strong international competitiveness and business development efforts, prevailing yen/dollar exchange rates, and rising Japanese vehicle assembly capacity in the United States.

- Our associations also are concerned that these plans vary significantly in terms of their annual business growth expectations, timeframe, and Japanese import component. We are particularly disappointed in Japanese industry's modest expectations for expanded imports of automotive parts into Japan.

- Similarly, the Japanese government's action plan falls short of the goals set forth by U.S. industry in the U.S.-Japan Framework negotiations. This plan does not address the need for removal of major Japanese regulatory barriers which limit access for U.S. and other foreign service and repair parts to the Japanese automotive aftermarket.

- We note that this plan seems to acknowledge a role for ongoing U.S. and Japanese government monitoring of, and responsibility for, promoting continued growth in Japanese purchases from U.S. automotive suppliers. However, the plan fails to acknowledge the critical need to evaluate trends in Japanese purchases from non-Japanese affiliated U.S. suppliers, in addition to trends in overall Japanese purchases from U.S. suppliers.

Size, Causes and Impact of U.S. Automotive Parts Trade Deficit with Japan

- The persistent U.S. automotive parts trade deficit with Japan has reached an unsustainable high level ($11 billion in 1993) and is continuing to grow. In some cases, replacement parts imported from Japan may not comply with U.S. laws on environmental protection and predatory pricing.

- This massive trade imbalance, accounting for roughly 10 percent of annual U.S. production of automotive parts and 20 percent of the total U.S.-Japan trade deficit, represents a serious threat to the economic well-being of U.S. automotive parts manufacturers and the United States as a whole. Key U.S. technologies, manufacturing capabilities, and jobs will continue to be lost if this threat is not addressed in a prompt and realistic way.

- Structural, rather than cyclical industrial or macroeconomic factors are principally responsible for the U.S. parts trade imbalance with Japan. Appropriate yen/dollar exchange rates are a necessary, but an insufficient prerequisite for long-term reductions in this structural deficit. Changes in Japanese industry business practices and government policies are keys to reaching this goal.

- The history of U.S.-Japan trade relations in the automotive and other sectors indicates that progress occurs far more rapidly if:

  1) U.S. and Japanese industry are actively engaged in joint business development activities;

  2) Japanese industry sets and announces realistic yet ambitious goals for expanding purchases from all U.S. suppliers, ensuring non-discriminatory consideration of potential new suppliers;

  3) Japanese government commits itself to implementation of meaningful deregulation and/or antitrust enforcement programs to eliminate non-tariff barriers impeding imports in specific industries; and

  4) Results of industry-to-industry business development initiatives and government action plans are closely monitored using agreed systems of measurement.

- This approach is fully consistent with U.S. goals in the U.S.-Japan Framework talks which broke down last month.

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U.S. Automotive Parts Industry Seeks Market Opening and Deregulation in Japan

- The U.S. automotive parts industry seeks fundamental improvements in its access to Japanese motor vehicle and equipment producers operating in Japan and the United States and full deregulation of the Japanese automotive aftermarket.

- This can only be accomplished through effective implementation and joint government and industry monitoring of at least a five-year Japanese action plan to achieve the following specific goals:

  1) Expand Japanese purchases of U.S. auto parts on a non-discriminatory basis for use in the manufacture and service of vehicles in the United States and Japan.

     To achieve the critically important goal of non-discrimination in Japanese procurement, there must be close monitoring of trends in both aggregate Japanese parts purchases and Japanese purchases from non-Japanese affiliated U.S. suppliers.

  2) Increase the average U.S. parts and materials content in Japanese-make vehicles built in the U.S. and Canada to levels comparable to those maintained by Chrysler, Ford and General Motors in North America.

  3) Eliminate anti-competitive and unnecessary Ministry of Transport (MOT) regulations affecting the motor vehicle service and repair industry in Japan, which limit import competition.

- In addition to negotiating a results-oriented auto parts trade agreement with Japan as outlined above, our seven associations urge the U.S. government to continue to pursue the following broader policies:

  1) Address the distinct, vitally important trade concerns of U.S. motor vehicle manufacturers with respect to regulatory and market access barriers that severely limit motor vehicle imports into Japan; and

  2) Maintain appropriate valuation of the yen against the U.S. dollar.

- These two additional steps are essential to reinforce U.S. automotive products manufacturers' efforts to increase exports to Japan and substantially expand use of U.S. parts in U.S.-built Japanese vehicles.

## APPENDIX 2.—FURTHER EXPLANATION OF BILATERAL PER CAPITAL IMPORT FIGURES SUBMITTED BY LARRY CHIMERINE, VICE PRESIDENT AND CHIEF ECONOMIST, ECONOMIC STRATEGY INSTITUTE

Thank you for allowing me to express my views before the House Subcommittee on Commerce, Consumer, and Monetary Affairs. It is gratifying to see that Congress and the Administration are unified in the belief that there is a market access problem in Japan.

I would like to take this opportunity to clarify exactly why the bilateral per capita import figures referred to by Dr. Niskanen are misleading. According to Dr. Niskanen's testimony, Japan on a per capita basis already imports more from the United States than Americans import from Japan. In his view, the near equality of per capita import figures is evidence that the Japanese economy is relatively open.

As the following example indicates, nothing could be further from the truth. Assume a world with three countries -- Country A, Country B, and Country C -- with populations of five, two, and one, respectively. (These ratios approximate the relative population makeup of China, the United States, and Japan.) Also, assume that each country imports $2 worth of goods on a per capita basis from each of its trading partners. Country A would import $10 worth of goods from the Country B (5 people*$2) and $10 worth of goods from Country C; thus, total imports for the Country A would equal $20. Country B would import $4 (2 people*$2) worth from both Country A and Country C, and B's total imports would be $8. Country C, the one person country, would import $2 (1*$2) from each of its partners, and its import total would be $4.

Based on these *import* totals, Country A's *total exports* would be six dollars and its *trade deficit* would be $14; Country B's exports would be $12 and its *trade surplus* would be $4; and Country C's exports would equal $14 and its *trade surplus* would be $10. These import, export, and trade balance figures are shown in the table below.

| Country | Population | Bilateral Per Capita Imports | Per Capita Exports | Number of Trading Partners | Total Imports | Total Exports | Trade Balance |
|---|---|---|---|---|---|---|---|
| A | 5 | $2 | $1.20 | 2 | $20 | $6 | ($14) |
| B | 2 | $2 | $6 | 2 | $8 | $12 | $4 |
| C | 1 | $2 | $14 | 2 | $4 | $14 | $10 |

In short, in a world where per capita imports are equalized, countries would run trade surpluses with all more populous countries, and the most populated country would run a deficit with all of its trading partners. This is not the world in which we live. Clearly, Dr. Niskanen's emphasis on bilateral per capita import figures is misplaced.

We at ESI are dedicated to clarifying the debate over the lack of market access in Japan. Please let me know if I can be of further assistance.

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